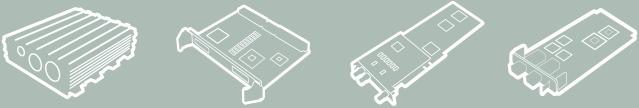


## 2004 Annual Report



## Our Fellow Shareholders

This has been a successful year for SBS. We grew sales by 15.9% to \$133.9 million, the second highest annual sales in the Company's history. For the second year in a row, we achieved a book-to-bill ratio of just over 1 to 1. In addition, our cash balance grew from \$37.1 million at the beginning of the fiscal year to \$47.9 million at the end of the year, and SBS continues to be debt free.

At the beginning of the past fiscal year, we published a short and long-term financial model for the Company that set out financial objectives for the next 12-18 months, and 18-36 months. I am pleased to report that for both the third and fourth quarters of the fiscal year, excluding employee severance and consolidation costs, operating income was 9% of sales, a key financial objective we set in our financial model. At the same time, both SG&A expense at 22.5% of sales, and R&D expense at 14.4% of sales, were in line with our model.

Our strategy of developing new products with strong intellectual property, focusing on our markets and tailoring solutions that help our customers succeed, remains unchanged. We released 37 new products during the fiscal year, and our engineering teams are continuing to focus on new product development. Our sales and business development teams closed 34 major design wins for the year, and our opportunity base continues to grow.

Beginning in fiscal year 2004, we reported our financial results by geographic regions, as well as by markets. We will continue the same reporting structure for fiscal year 2005, as I believe it is important to not only recognize our market diversity but also focus on the global nature of our business. One result of our global outlook is the success of our European operation located in Germany. SBS Europe sells and supports all SBS product in Europe. The European market grew by 60% this fiscal year and is now 27% of total Company sales.

In June, we completed the next step in our globalization by establishing a subsidiary in mainland China. SBS Technologies (Shen-zhen) Limited, referred to as SBS Asia, promotes and supports all SBS product to the Asian market. Although SBS has been active in Asia for many years, we worked with distributors providing them sales and support from North America. In order to grow our Asian business from the current level of 5% of Company sales to a target level of 30% in the next three to five years, we realized that we needed to support Asia from an Asian base. We have initially staffed the new Shenzhen facility with several sales support and technical engineering support people to assist our distributors and their customers on a local level. As we gain knowledge of the Asian market and business practices, we will expand the size and scope of SBS Asia to provide sales and limited engineering and manufacturing capabilities in Asia. I see the new subsidiary as the appropriate way to support and grow our presence in Asia, similar to our approach in Europe.

While we were disappointed in the softness of our business in the first quarter of fiscal year 2005, we remain optimistic that we will achieve our objectives as we progress through this new year. Reviewing our markets, we believe the government market will remain strong. We experienced growth of 12.4% in this market in fiscal year 2004, and this market represents 51% of total company sales. As planned, the majority of our design wins and new opportunities are for system level solutions. The military budget is still heavily focused on unmanned vehicles and upgrade programs. Both of these are areas where SBS has been successful and is positioned to win new business.

In the commercial market, we grew 6.1% in fiscal year 2004, and this market represents 30% of total company sales. We expect steady demand from semiconductor and medical equipment manufacturers, and we are optimistic that we will see growth in the industrial automation market in fiscal year 2005.

Sales to communications customers increased 49.4% in fiscal year 2004, and this market represents 19% of total company sales. We expect additional growth in the communications market in fiscal year 2005. Our traditional markets of wireless and network monitoring continue to show growth, and, with the addition of Advanced Telecom Computing Architecture-based products, we are expanding into new opportunities.

Fiscal Year 2004 was my first full year as CEO of SBS. Without the support and hard work of all of the dedicated employees, we would not have achieved a successful year. I would also like to thank our shareholders, customers and suppliers who continue to partner with us. Your support is sincerely appreciated. I am optimistic about the future of SBS and remain committed to building shareholder value by managing the business profitably and cost effectively. We are focused on growth and will continue to invest in new technology and product development that will solve more of our customers' needs.



Clarence W. Peckham  
CEO, SBS Technologies, Inc.



**2400 Louisiana Blvd. NE  
AFC Building 5, Suite 600  
Albuquerque, New Mexico 87110  
Tel. (505) 875-0600**

**PROXY STATEMENT AND NOTICE OF  
ANNUAL MEETING OF SHAREHOLDERS  
To Be Held on November 18, 2004**

Dear Shareholders:

You are cordially invited to attend the SBS Technologies, Inc. 2004 Annual Meeting of Shareholders, which will be held on Thursday, November 18, 2004 at 8:30 a.m. Mountain Standard Time, at the Sheraton Uptown Albuquerque Hotel, 2600 Louisiana Blvd. NE, Albuquerque, New Mexico 87110. The purpose of the meeting is to act on the following:

- (1) To elect seven Directors;
- (2) To ratify the appointment of KPMG LLP as our independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005; and
- (3) To transact any other business as may properly come before the meeting.

If you were a shareholder of record at the close of business on September 29, 2004, you may vote by proxy or in person at the Annual Meeting. Your vote is important. Whether or not you plan to attend the meeting, please complete, date, and sign the enclosed proxy card, and mail it in the enclosed business reply envelope. For your convenience, you may also vote your shares via telephone or Internet according to the instructions on the proxy card. If you vote your proxy over the telephone or Internet, please do not mail in your completed proxy card. If you are a registered shareholder and wish to vote your shares in person at the meeting, you may do so even if you have previously returned your proxy card. However, if you hold your shares in Street Name and wish to vote your shares in person at the meeting, you must indicate that on your proxy card as instructed and return it before the meeting in the envelope provided.

A handwritten signature in black ink, appearing to read "Bruce E. Castle".

Bruce E. Castle  
*Secretary*

October 11, 2004

## TABLE OF CONTENTS

	<u>Page</u>
INFORMATION ABOUT THE ANNUAL MEETING .....	1
OWNERSHIP OF SBS COMMON STOCK.....	5
How Much Stock Do Shareholders Who Have More Than 5% Of Common Stock Own?.....	5
How Much Stock Do The Directors And Executive Officers Own?.....	5
BOARD OF DIRECTORS .....	6
Would You Please Describe The Structure Of The Board Of Directors?.....	6
Nominees For The Board Of Directors .....	7
CORPORATE GOVERNANCE .....	8
Does SBS Have An Ethics Program? .....	9
Does The Board Of Directors Have Committees?.....	9
What Independence Requirements Apply To The Board Of Directors And Its Committees? .....	10
Do The Independent Directors Meet Separate From Management?.....	10
How Can Shareholders Communicate With The Board? .....	11
What Is The Board's Policy Regarding Annual Meeting Attendance? .....	11
How Are Directors Nominated? .....	11
How Much Are The Directors Paid? .....	13
COMPENSATION OF EXECUTIVE OFFICERS .....	14
Executive Officers Who Are Not Directors.....	14
How Much Do The Executive Officers Get Paid .....	15
Compensation Plans Of SBS Under Which Securities May Be Issued .....	17
Does SBS Have Employment Agreements For The Executive Officers .....	18
REPORTABLE TRANSACTIONS .....	19
SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE.....	19
INDEPENDENT PUBLIC ACCOUNTANTS .....	19
REPORT OF THE AUDIT COMMITTEE .....	20
REPORT OF THE MANAGEMENT DEVELOPMENT AND COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION .....	21
REPORT OF THE CORPORATE GOVERNANCE AND NOMINATING COMMITTEE .....	23
FIVE YEAR PERFORMANCE COMPARISON .....	24
ANNUAL REPORT .....	24
PROPOSALS TO BE VOTED UPON .....	25
To Elect Seven Directors.....	25
To Ratify the Appointment of Principal Independent Registered Public Accountants.....	25
OTHER MATTERS .....	25
APPENDIX A – Audit Committee Charter .....	26
APPENDIX B – Corporate Governance and Nominating Committee Charter.....	29
APPENDIX C – Management Development and Compensation Committee Charter .....	30

# **PROXY STATEMENT FOR SBS TECHNOLOGIES, INC.**

## **2004 ANNUAL MEETING OF SHAREHOLDERS**

### **INFORMATION ABOUT THE ANNUAL MEETING**

#### **What is the Purpose of the Annual Meeting?**

At the Annual Meeting, shareholders of SBS Technologies, Inc. ("SBS," the "Company" or "we") will act upon matters described in the Notice of Annual Meeting that accompanies this Proxy Statement, including the election of seven Directors and the ratification of the Audit Committee's selection of KPMG LLP as our independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005.

#### **Why Did You Send Me This Proxy Statement?**

We sent you this proxy statement and the enclosed proxy card because our Board of Directors is asking you to vote for two items or, if you prefer, asking your permission to allow us to vote your shares at the 2004 Annual Meeting of Shareholders. The Annual Meeting will be held on November 18, 2004 at the Sheraton Uptown Albuquerque Hotel, 2600 Louisiana Blvd. NE, Albuquerque, New Mexico 87110, at 8:30 a.m. Mountain Standard Time. This proxy statement includes information about the issues to be voted upon at the meeting, and on the transaction of such other business as may properly come before the meeting.

On October 11, 2004, we began mailing these proxy materials to all shareholders of record at the close of business on September 29, 2004. On August 13, 2004, there were 15,503,774 shares of SBS common stock outstanding and entitled to vote.

In accordance with New Mexico law, a list of shareholders entitled to vote at the Annual Meeting will be available on November 18, 2004 at the Sheraton Uptown Albuquerque Hotel, 2600 Louisiana Blvd. NE, Albuquerque, New Mexico 87110 and for 10 days before the meeting, between the hours 8:30 a.m. and 5:30 p.m., at SBS' Corporate Headquarters, 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, New Mexico, 87110.

#### **Who Can Attend the Meeting?**

Only shareholders who owned SBS common stock as of September 29, 2004, or their duly appointed proxies, will be entitled to attend the Annual Meeting. If you hold your shares through a broker, bank or other nominee, you will not be admitted to the Annual Meeting unless you bring a copy of a statement (such as a brokerage statement) from your nominee reflecting your stock ownership as of September 29, 2004.

#### **What Constitutes a Quorum?**

The Annual Meeting will be held only if a quorum is present. A quorum will be present if a majority of the shares of SBS common stock issued and outstanding on September 29, 2004 are represented, in person or by proxy, at the Annual Meeting. Shares represented by properly completed proxy cards either marked "abstain" or "withhold authority to vote", or returned without voting instructions are counted as present for the purpose of determining whether a quorum is present. Also, if shares are held by brokers who are prohibited from exercising discretionary authority for beneficial owners who have not given voting instructions ("broker nonvotes"), those shares will be counted as present for quorum purposes.

#### **How Many Votes Do I Have?**

If you were a shareholder at the close of business on September 29, 2004, you will be entitled to vote. Each share of SBS common stock that you own entitles you to one vote.

## **How Can I Vote My Shares?**

You can vote on matters presented at the Annual Meeting by proxy in three ways or in person:

**(A) By Proxy** — If you are a shareholder of record, you may vote your proxy by mail, telephone or the Internet. Telephone and Internet voting procedures are designed to authenticate shareholders by using individual control numbers. Voting by telephone or Internet will help SBS reduce costs.

### ***Voting Your Proxy by Telephone***

In the U.S. and Canada, you can vote your shares by telephone by calling the toll-free telephone number on your proxy card. Telephone voting is available 24 hours a day, 7 days a week, until 12:00 p.m. Central Standard Time on November 17, 2004. Easy-to-follow voice prompts allow you to vote your shares and confirm that your instructions have been properly recorded. If you vote by telephone, you do not need to return your proxy card.

### ***Voting Your Proxy by Internet***

You can also choose to vote over the Internet. The web site address for Internet voting is on your proxy card. Internet voting is available 24 hours a day, 7 days a week, until 12:00 p.m. Central Standard Time on November 17, 2004. If you vote over the Internet, you do not need to return your proxy card. Please note that if you vote over the Internet, you may incur costs such as telecommunication and Internet connection charges associated with normal Internet usage.

### ***Voting Your Proxy by Mail***

If you choose to vote by mail, simply mark your proxy card, date and sign it, and return it as instructed on the proxy card in the postage paid envelope provided.

If you vote by proxy using any of these three methods, the persons named on the card (your “proxies”) will vote your shares in the manner you indicate. You may specify whether your shares should be voted for all, some, or none of the nominees for Director, and whether your shares should be voted for or against the ratification of the appointment of the principal independent registered public accountants for fiscal year 2005. If you vote by telephone or Internet and choose to vote with the recommendation of SBS’ Board of Directors, or if you vote by mail, sign your proxy card, and do not indicate specific choices, your shares will be voted:

- “FOR” the election of all seven nominees for Director; and
- “FOR” ratification of the appointment of the principal independent registered public accountants for the fiscal year ending June 30, 2005.

If a nominee becomes unable to serve as Director, which we do not anticipate, your proxies intend to vote for the election of a substitute nominee recommended by the Board of Directors.

If any other matter is presented, your proxies will vote in accordance with the best judgment of management. At the time this proxy went to press, we knew of no matters that needed to be acted on at the Annual Meeting other than those discussed in this proxy statement.

If you wish to give a proxy to someone other than the persons named on the enclosed proxy card, you may strike out the names appearing on the card and write in the name of any other adult person, sign the proxy, and deliver it to the person whose name has been substituted.

**(B) In Person** — If you are a shareholder of record, you may cast your vote in person at the Annual Meeting. In order to vote at the meeting, shareholders must present a form of personal identification. If you hold your shares in Street Name, please see the section below entitled “If I Hold Shares In Street Name, How Can I Vote My Shares?” for information on how to vote your shares in person at the Annual Meeting.

## **If I Hold Shares In Street Name, How Can I Vote My Shares?**

You can submit voting instructions to your broker or nominee. If you wish to vote in person at the Annual Meeting, please refer to the voting instruction card included in the materials provided by your broker or nominee. You will be required to bring with you a legal proxy covering your securities issued to you in accordance with the voting instruction card.

## **May I Revoke My Proxy?**

If you give a proxy, you may revoke it at any time before it is exercised. You may revoke your proxy in any one of three ways:

- send another proxy with a later date,
- notify SBS' Secretary in writing to arrive at SBS' Corporate Headquarters, 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, New Mexico, 87110, before the date of the Annual Meeting that you have revoked your proxy, or
- vote in person at the Annual Meeting.

## **How Can I Present An Issue To Be Addressed At Next Year's Annual Meeting?**

Shareholders must submit proposals, intended to be considered at the next Annual Meeting, in writing to the Secretary of SBS, no later than June 13, 2005, for inclusion in SBS' Proxy Statement and Form of Proxy relating to the meeting. Also, shareholders who wish to propose proper business from the floor, for consideration at the 2005 Annual Meeting of Shareholders, and who have not properly submitted that proposal for possible inclusion in SBS' 2005 proxy materials, must notify SBS' Secretary in writing no later than August 27, 2005.

## **How Will Broker Non-votes be Treated?**

We will treat broker non-votes as present to determine whether or not we have a quorum at the meeting, but they will not be treated as entitled to vote on the proposals, if any, for which the broker indicates it does not have discretionary authority.

## **Will my Vote be Kept Confidential?**

Yes. As a matter of policy, shareholder proxies, ballots and tabulations that identify individual shareholders are kept secret and are available only to SBS' tabulator, which is required to keep your votes confidential.

## **Who Will Count the Votes?**

SBS' tabulator, Wells Fargo Bank, N.A., will count the votes.

## **Who Pays to Prepare, Mail and Solicit These Proxies?**

SBs pays all of the costs of preparing, mailing and soliciting proxies. SBS asks brokers, banks, voting trustees and other nominees and fiduciaries to forward proxy materials to the beneficial owners and to obtain authority to execute proxies. We will reimburse the brokers, banks, voting trustees and other nominees and fiduciaries upon request. We have engaged our transfer agent, Wells Fargo Bank, N.A., to assist in the distribution and tabulation of proxies. A few employees of SBS may also participate, without additional compensation, in the solicitation of proxies by telephone, facsimile, e-mail, and personally. SBS does not currently intend to engage any third party to assist with proxy solicitation, and therefore we do not expect the expenses, if any, for proxy solicitation to exceed \$5,000.

## **What are the Board's Recommendations?**

The Board recommends a vote “FOR” the election of the seven Director nominees and the Board and the Audit Committee recommend the ratification of the Audit Committee’s selection of KPMG LLP as our independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005. With respect to any other matter that is properly brought before the meeting, the proxy holders will vote the proxies held by them in accordance with their best judgment.

## **What Vote Is Required To Approve Each Proposal?**

### *Proxy Item No. 1*

Election of Directors:

Each Director who receives a “FOR” vote by a majority of shares represented in person or by proxy at the Annual Meeting will be elected. If you vote to withhold authority to vote for all listed nominees or if you vote to withhold authority for a particular nominee, your vote will count as a vote “AGAINST” the nominee(s). Otherwise, your vote will count “FOR” the nominee(s).

### *Proxy Item No. 2*

Ratification of Appointment of KPMG LLP as Independent Registered Public Accountants:

A “FOR” vote by a majority of the shares represented in person or by proxy at the Annual Meeting is required to ratify the appointment of KPMG LLP as our independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005. If you “ABSTAIN” from voting, your abstention has the same effect as if you voted “AGAINST” the proposal.

*Please note the following:*

Shares not voted by brokers and other entities holding shares on behalf of beneficial owners will not be counted in calculating voting results on those matters for which the broker or other entity has not voted.

## **What if Other Matters Come up During the Meeting?**

If any matters other than those referred to in the Notice of Annual Meeting properly come before the meeting, the individuals named in the accompanying form of proxy will vote the proxies held by them in accordance with their best judgment. SBS is not aware of any business other than the items referred to in the Notice of Annual Meeting that may be considered at the meeting.

## **Multiple Individuals Who Reside in my Home are Beneficial Owners of Shares of SBS Common Stock. Why did we Receive Only One Copy of this Proxy Statement?**

We are sending only one proxy statement to you if you share a single address with another shareholder unless we received instructions to the contrary from you. This practice, known as “householding,” is designed to eliminate duplicate mailings, conserve natural resources and reduce our printing and mailing costs. If you wish to receive a separate proxy statement in the future, you may contact SBS Investor Relations by telephone at (505) 875-0600, by mail at 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, NM 87110, or by email at [jwade@sbs.com](mailto:jwade@sbs.com). If you receive multiple copies of our Proxy Statement, you can request householding by contacting SBS Investor Relations. If you own your shares through a broker, bank or other holder of record, you can request householding by contacting the holder of record.

## **How Can I Obtain Electronic Access to the Proxy Statement and Annual Report?**

This Proxy Statement and our 2004 Annual Report may be viewed in the *Financial Reports & Filings* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir).

## OWNERSHIP OF SBS COMMON STOCK

### How Much Stock Do Shareholders Who Have More Than 5% of Common Stock Own?

The following table sets forth, as of June 30, 2004, the beneficial ownership of common stock by each person who is known by SBS to own beneficially more than 5% of the outstanding shares of common stock:

<b>Name and Address of Beneficial Owner</b>	<b>Amount and Nature of Beneficial Ownership (1)</b>	<b>Percent of Class Beneficially Owned (2)</b>
Wellington Management Co. LLP (3)	1,492,330	9.63%
Fidelity Management & Research Co. (4)	1,370,800	8.85%
Barclays Global Investors, N.A. (5)	1,181,394	7.62%
Kennedy Capital Management, Inc. (6)	864,773	5.58%
T. Rowe Price Associates, Inc. (7)	824,200	5.32%

- (1) The ownership information disclosed above is based on a Schedule 13F report dated June 30, 2004 filed with the Securities and Exchange Commission.
- (2) To SBS' knowledge, except where otherwise noted, each person listed has sole voting power of the shares.
- (3) The address for the shareholder is in care of Wellington Management Co. LLP, 75 State Street, Boston, Massachusetts, 02109-1809.
- (4) The address for the shareholder is in care of Fidelity Management & Research Co., One Federal Street, Boston, Massachusetts 02110-2003.
- (5) The address for the shareholder is in care of Barclays Global Investors, N.A., 45 Fremont Street, San Francisco, California, 94105-2228.
- (6) The address for the shareholder is in care of Kennedy Capital Management, Inc., 10829 Olive Boulevard, St. Louis, Missouri, 63141-7739.
- (7) The address for the shareholder is in care of T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, Maryland, 21202-1008.

### How Much Stock Do The Directors And Executive Officers Own?

The following table sets forth, as of August 13, 2004, the beneficial ownership of common stock by each Director and nominee for Director of SBS, each Executive Officer, and by all Directors and Executive Officers as a group (see footnotes for explanations):

<b>Name of Beneficial Owner</b>	<b>Amount and Nature of Beneficial Ownership (1)</b>	<b>Percent of Class Beneficially Owned (6)</b>
Christopher J. Amenson (7) (nominee)* .....	345,113 (3,5,8)	2.23%
Warren W. Andrews (nominee)* .....	45,600 (5)	(2)
Lawrence A. Bennigson (nominee)* .....	84,069 (4,5)	(2)
Bruce E. Castle (7) .....	16,417 (3,5)	(2)
James E. Dixon, Jr. (7) .....	129,802 (3,5,9)	(2)
Peter D. Fenner (nominee)* .....	36,441 (4,5)	(2)
David H. Greig (7) .....	155,100 (5)	1.00%
Clarence W. Peckham (nominee)* (7) .....	139,443 (3,5)	(2)

<u>Name of Beneficial Owner (Continued)</u>	<u>Amount and Nature of Beneficial Ownership (1)</u>	<u>Percent of Class Beneficially Owned (6)</u>
Richard Szafranski (nominee)* .....	11,088 (5)	(2)
Alan F. White (nominee)* .....	51,636 (5)	(2)
All Directors and Executive Officers as a group .....	1,014,709	6.54%

\* Director as of August 13, 2004.

On August 13, 2004, there were 15,503,774 shares of SBS common stock outstanding.

The address for each of these shareholders is in care of SBS at 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, NM 87110.

- (1) A person is deemed to be the owner of securities that can be acquired by that person within 60 days of the date of the table upon exercise of options. Each beneficial owner's percentage ownership is determined by assuming that options that are held by that person and that are exercisable within 60 days of the date of this table have been exercised.
- (2) Owns less than one percent of total outstanding stock.
- (3) Includes common stock owned by this person through the SBS Technologies, Inc. 401(k) Profit Sharing Plan ("401(k) Plan"): Christopher J. Amenson 4,717 shares; Bruce E. Castle 467 shares; James E. Dixon, Jr. 2,184 shares; and Clarence W. Peckham 443 shares.
- (4) Mr. Bennigson and Mr. Fenner elected to receive restricted shares of SBS common stock in lieu of cash compensation for their 2003/2004 term. Upon completion of their current year terms on November 17, 2004, Mr. Bennigson will receive 3,750 shares and Mr. Fenner will receive 2,500 shares.
- (5) Includes, as to the person listed, options to purchase shares of common stock exercisable as of August 13, 2004 and for 60 days thereafter, under SBS' stock option plans: Christopher J. Amenson 270,000 options, Warren W. Andrews 34,450 options, Lawrence A. Bennigson 50,000 options, Bruce E. Castle 13,750 options, James E. Dixon, Jr. 127,000 options, Peter D. Fenner 30,000 options, David H. Greig 155,100 options, Clarence W. Peckham 139,000 options, Richard Szafranski 9,769 options, and Alan F. White 43,483 options.
- (6) To SBS' knowledge, except where otherwise noted, each person has sole voting and investment power as to the shares.
- (7) Is an Executive Officer.
- (8) Includes 1,000 shares owned indirectly by his spouse and 2,000 shares owned indirectly by his minor children.
- (9) Includes 618 shares owned indirectly which are held in his spouse's SBS 401(k) account.

SBS knows of no arrangements concerning anyone's ownership of stock, which may, at a subsequent date, result in a change in control of SBS.

## BOARD OF DIRECTORS

### Would You Please Describe The Structure Of The Board Of Directors?

SBS' Bylaws provide for a Board of Directors composed of a minimum of one but not more than nine Directors, all of whom are elected annually. The Board of Directors determines on an annual basis the number of Board positions, and, therefore, the number of nominees to be recommended to the Shareholders for election to the Board. For the annual term ending November 17, 2004, eight Directors were elected on November 13, 2003. All of these Directors, except Louis C. Golm who resigned in April 2004, are expected to fulfill their terms. For the annual term commencing November 17, 2004, the Board has determined that the Board will consist of seven Directors. Vacancies in the Board occurring during a term are filled by persons appointed by a majority of the remaining Board members. A Director appointed to fill a vacancy, or a new Directorship created by an increase in the size of the Board, serves for the remainder of the term.

The Board of Directors held 13 regular and special meetings during the fiscal year ended June 30, 2004. No incumbent Director attended less than 75% of the total of the Board meetings and meetings of Committees on which he served.

At the Annual Meeting of Shareholders, seven Directors will be elected by the holders of common stock to hold office until the Annual Meeting of Shareholders in 2005, and until their successors are elected, or until their death, resignation, or removal.

At the Annual Meeting of the Board of Directors, the Board elects a Chairman of the Board and a Lead Director, who must be an independent Director, to preside over meetings of the Independent Directors.

The following persons, all of whom currently serve as Directors, have consented to be nominated and, if elected, to serve as Directors of SBS.

### **Nominees for the Board of Directors**

*Christopher J. Amenson*, 54, became a Director in August 1992. Mr. Amenson served as Chairman of the Board from May 1997 to November 2001 and from April 2002 to the present. Mr. Amenson was appointed Executive Chairman on April 17, 2003. Mr. Amenson served as President of SBS from April 1992 through March 2001 and Chief Executive Officer of SBS from October 1996 through March 2001, when he retired to pursue faith-based ministry, and from April 2002 to April 2003. From April 1992 to October 1996, Mr. Amenson was Chief Operating Officer of SBS. For five years before joining SBS, Mr. Amenson was President of Industrial Analytics, Inc., a Boston-based firm engaged in consulting in support of operations, mergers and acquisitions. Mr. Amenson also serves on the Boards of Directors of Rainbow House International, the Technical-Vocational Institute Foundation, PointCross, Inc., and is Chairman of the Board of Best Choice Educational Services, Inc. Mr. Amenson holds a Bachelor's Degree in Government from the University of Notre Dame and a Master of Science in Management from the Massachusetts Institute of Technology ("MIT") as a Sloan Fellow.

*Warren W. Andrews*, 61, became a Director in November 1996. Mr. Andrews is a market and technology analyst, and is publisher and editorial director of two monthly magazines, RTC Magazine and COTS Journal. The former is the leading publication in the open-systems, embedded-computer industry, and the latter covers embedded computers in the military. He serves on the Advisory Board of BitMICRO Networks, a manufacturer of solid-state storage devices. From 1987 to 1994, Mr. Andrews served as a senior editor for Computer Design Magazine while, at the same time, publishing his own newsletter, Embedded Computer Trends. Before that he was managing editor of Electronic Design Magazine and semiconductor editor for Electronic Engineering Times. Previously, he owned and operated his own business, providing electronic design services and developing, manufacturing and selling microprocessor-based switching systems for a variety of audio and video applications. In addition, he holds one U.S. patent and has designed other products for the cable TV, security systems, education and communications markets. Mr. Andrews holds a Bachelor of Science Degree from Fairleigh Dickinson University.

*Lawrence A. Bennigson, Ph.D.*, 67, became a Director in November 1995 and serves as Lead Director and Chairman of the Management Development and Compensation Committee. Dr. Bennigson has provided consulting services on corporate, business and manufacturing strategy and related organizational issues to major corporations and to governments in the U.S. and Europe since 1965. In 1998, he was appointed a Senior Fellow of the Harvard Business School's Executive Development Center and in 2003 he was appointed Senior Fellow, Custom Programs, Executive Education, Harvard Business School. Dr. Bennigson serves on several advisory boards, including Toffler Associates, the strategic advisory firm founded by Alvin and Heidi Toffler. As Senior Vice President and a Managing Partner of the former MAC Group, Inc., Dr. Bennigson helped lead the strategic development of the firm, resulting in its 1991 acquisition and merger to become Gemini Consulting. Dr. Bennigson taught executives and graduate students as a faculty member of the School of Engineering, Stanford University, the Harvard University Graduate School of Business, and as a visiting faculty member at the London Business School and the Graduate School of Business, Lund University, Sweden. Before his academic and consulting career, Dr. Bennigson served for six years as a U.S. Naval Officer. Dr. Bennigson holds a Bachelor's Degree in General Engineering from UCLA, as well as Master's and Doctorate Degrees in Industrial Engineering (with specialization in Human Factors Engineering and Industrial Organization) from Stanford University.

*Peter D. Fenner*, 68, became a Director in November 2000 and serves as Chairman of the Audit Committee. On January 1, 2001, Mr. Fenner retired after 5 years as President and CEO of Com21, Inc. Before joining Com21,

Mr. Fenner was, for over 30 years, with AT&T, where he held numerous sales, marketing, product planning, and senior management positions. From 1989 to 1992, Mr. Fenner was President and a corporate officer of AT&T Network Systems' Transmission Business, a \$3 billion unit with 10,000 employees. In this position, he was instrumental in the quality efforts that resulted in winning the Malcolm Baldridge Award. Before that, Mr. Fenner was Vice President of Product Planning for AT&T's entire \$12 billion Network Systems Division, with operations that included Transmission Systems, Switching, Cellular, Cable & Wire, and Operations Support (Software). Mr. Fenner is also on the Board of Directors of BitMICRO Networks, a company producing solid state storage devices, and ActiveStrategy, a pioneer in software designed to manage the process of "Strategy Execution." Mr. Fenner holds a Bachelor of Science Degree in Industrial Engineering from Lehigh University and a Master of Science in Management from MIT as a Sloan Fellow.

*Clarence W. Peckham*, 55, was appointed a Director and Chief Executive Officer on April 17, 2003. Before that, Mr. Peckham was appointed Executive Vice President of SBS in February 2002, and served as President of SBS' Commercial and Government Group. In February 2001, Mr. Peckham was appointed President of SBS' Government Group and for the period 1997 to 2001, Mr. Peckham was President of SBS' wholly owned subsidiary, SBS Technologies, Inc., Embedded Computers in Raleigh, North Carolina. Before joining SBS in 1997, Mr. Peckham was Vice President of Engineering and Chief Technologist at DY4 Systems in Canada, a leading supplier of military computer systems. Mr. Peckham has over 30 years' experience in the embedded computing field. Mr. Peckham holds a Bachelor of Science Degree in Electrical Engineering from Northeastern University.

*Richard Szafranski*, 56, was appointed a Director on January 10, 2003. Mr. Szafranski is the managing partner of Toffler Associates. Mr. Szafranski retired from active service in the United States Air Force as a colonel in July 1996. In his last assignment, he was the National Military Strategy Chair at the Air War College, Maxwell AFB, Alabama and the study director for Air Force 2025. While serving, Colonel Szafranski's duties included staff positions in the headquarters of Strategic Air Command, United States Space Command, North American Aerospace Defense Command, and Air Force Space Command. He commanded B-52 units at the squadron and wing level, including assignment as commander of the 7th Bomb Wing, Carswell AFB. He is a member of the International Institute of Strategic Studies and a recipient of the US Air Force Association National Medal of Merit. He serves on the Board of Reviewers for the Aerospace Power Journal, the professional Journal of the United States Air Force. Mr. Szafranski is a graduate of Air Command and Staff College. He holds a BA in English from Florida State University and an MA in Human Resources Management from Central Michigan University.

*Alan F. White*, 66, became a Director in November 1997 and serves as Chairman of the Corporate Governance and Nominating Committee. Mr. White is Senior Associate Dean at the MIT Sloan School of Management and a member of the MIT Faculty (Ex Officio). Mr. White began his career at MIT in 1973, as an Alfred P. Sloan Fellow, and later served as Director of that Program. From 1973 to 1988, Mr. White served as Director of Executive Education at MIT. Mr. White serves on the boards of Ceridian Corporation (NYSE: CEN), StartupAvenue.com (France), Management Sciences for Health, and the advisory board of the Japan Management Institute. Mr. White has served as a consultant in the area of management development and business development to many organizations, including British Petroleum PLC, Citicorp, Inc., Gemini Consulting, and the Young Presidents' Organization. Mr. White holds a Bachelor's Degree in Political Science from the University of Miami (Ohio) and a Master of Science in Management from MIT as a Sloan Fellow.

There are no family relationships among any Directors or executive officers of SBS. Information about the stock ownership in SBS held by these individuals is shown under the heading "Ownership of SBS common stock" and is based on information provided by these individuals.

## CORPORATE GOVERNANCE

### Overview

The Board of Directors has adopted a written Statement on Corporate Governance (the "Statement"), a copy of which is available in the *Corporate Governance* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir), to assist it in the performance of its duties and the exercise of its responsibilities. The Statement reflects the view of the Board with respect to corporate governance issues generally. The Board believes that good corporate governance is a source of competitive advantage for SBS. Good governance allows the skills, experience and judgment of the Board to support our executive management team, enabling management to improve our performance and maximize shareholder value.

## **Does SBS have an Ethics Program?**

The Board has adopted a Code of Ethics applicable to all employees and Directors of SBS (the “Code of Ethics”). The Code of Ethics contains standards to which all SBS personnel must adhere in areas such as fair dealing, conflicts of interest, company information and confidentiality, compliance with laws, rules and regulations, corporate opportunities, and improper use of corporate funds or assets, and contain specific compliance and enforcement mechanisms. The Code of Ethics is available in the *Corporate Governance* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir). We will disclose future amendments to, or waivers, if any, from, the Code of Ethics on our website, [www.sbs.com](http://www.sbs.com), within two business days following the date of the amendments or waivers.

## **Does the Board of Directors Have Committees?**

The Board of Directors has three standing committees: Audit; Management Development and Compensation; and Corporate Governance and Nominating.

### ***Audit Committee***

Members: Peter D. Fenner (Chairman), Warren W. Andrews, and Lawrence A. Bennigson

The Audit Committee, which held eleven meetings in fiscal year 2004, consists of three Directors who are independent, as determined in accordance with all applicable rules and laws. Currently, the Board of Directors has determined that Mr. Fenner is an “audit committee financial expert” consistent with SEC rules.

The Audit Committee oversees the accounting and financial reporting processes and the audit of the financial statements of SBS, including (a) the integrity of SBS’ financial statements and internal control over financial reporting, (b) SBS’ compliance with legal and regulatory requirements, (c) the qualifications and independence of the independent registered public accountants, and (d) the performance of the independent registered public accountants. The Audit Committee serves as the sole authority to which the independent registered public accountants are accountable, and has the sole authority and responsibility for the appointment, compensation, retention and oversight of the work of the independent registered public accountants, including any non-audit relationship with the independent registered public accountants. The independent registered public accountants report directly to the Audit Committee and the Audit Committee is responsible for the resolution of any disagreements between management and the independent registered public accountants regarding financial reporting.

Effective June 10, 2004, the Audit Committee adopted a revised written charter, which is attached to this Proxy Statement as Appendix A, and is also available in the *Corporate Governance* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir).

### ***Corporate Governance and Nominating Committee***

Members: Alan F. White (Chairman), Warren W. Andrews, Peter D. Fenner and Richard Szafranski

The Corporate Governance and Nominating Committee, which held seven meetings in fiscal year 2004, consists of four Directors who are independent. The Corporate Governance and Nominating Committee has the responsibility to make recommendations to the Board with respect to nominees to be designated by the Board for election as Directors and officers, the effectiveness, structure, size and composition of the Board, including committee assignments, and to monitor corporate governance standards of the Company. The Board of Directors approves the proposed slate of nominees for recommendation to the shareholders. Nominated Directors stand for election by the shareholders at SBS’ Annual Meeting of Shareholders.

The Board of Directors has determined that each member of the Committee is independent as defined in NASD Rule 4200(A)(15), and qualified to serve on the Committee pursuant to the requirements of The Nasdaq Stock Market, Inc. ("NASDAQ"). Effective April 20, 2004, the Board of Directors adopted a written charter for the

Corporate Governance and Nominating Committee, which is attached to this Proxy Statement as Appendix B, and is also available in the *Corporate Governance* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir).

### ***Management Development and Compensation Committee***

Members: Lawrence A. Bennigson (Chairman), Richard Szafranski and Alan F. White

The Management Development and Compensation Committee, which held eight meetings in fiscal year 2004, consists of three Directors who are independent. The Committee is responsible for making recommendations to the Board of Directors concerning policies and procedures which will attract, develop and retain key managers and executives critical to the long-term success of SBS, and to align executive compensation with shareholder interests. The Management Development and Compensation Committee provides guidance and overview of all management development, executive salary, incentive and benefit programs. In addition, the Management Development and Compensation Committee is responsible for evaluating the performance of the Chief Executive Officer, recommending Chief Executive Officer compensation to the full Board, and meeting annually with the Chief Executive Officer to review management development programs and activities, and succession planning. While the administration of management development and compensation is the responsibility of SBS management, the review and recommendation of the Management Development and Compensation Committee is required for overall executive (individuals who lead businesses or functional responsibilities) compensation, philosophy and policy; incentive programs; executive benefit and perquisite programs; stock and stock option awards and their terms to be awarded to officers subject to Section 16(b) of the Securities Exchange Act of 1934; Board member compensation and any other compensation issues as may be directed to it. Effective February 7, 2003, the Board of Directors adopted a revised written charter for the Management Development and Compensation Committee, which is attached to this Proxy Statement as Appendix C, and is also available in the *Corporate Governance* section of our investor relations website at [www.sbs.com/ir](http://www.sbs.com/ir).

All members of the Management Development and Compensation Committee during the fiscal year ended June 30, 2004 were Independent Directors, and none of them was an employee or former employee of SBS. During the fiscal year ended June 30, 2004, no SBS executive officer served on the compensation committee (or equivalent), or the board of directors, of another entity whose executive officer(s) served on SBS' Management Development and Compensation Committee.

### **What Independence Requirements Apply to the Board of Directors and its Committees?**

The Statement requires that Directors who are independent of management constitute a substantial majority of the Board of Directors. In addition, NASDAQ listing standards require that a majority of the Board be independent of management. Those standards provide generally that no Director will be considered independent unless that Director has not received, directly or indirectly, any compensation or other benefit from SBS or an affiliate, other than in his capacity as a director or a member of a committee of the Board, for a period of at least three years. The Board has determined that all of the Director nominees, with the exception of Mr. Amenson and Mr. Peckham, are independent.

NASDAQ listing standards require that all members of the Audit Committee and the Corporate Governance and Nominating Committee be independent. The Statement adopted by our Board goes farther by requiring that all members of each standing committee of the Board be comprised solely of Independent Directors. As a result, neither Mr. Amenson nor Mr. Peckham serves on any standing committee of the Board.

### **Do the Independent Directors Meet Separate from Management?**

The Independent Directors meet separately at every regularly scheduled meeting of the Board. Those meetings are chaired by the duly elected Lead Director, who is an independent Director. Currently, the Lead Director is Lawrence A. Bennigson. The Independent Directors held five meetings in fiscal year 2004.

## **How can Shareholders Communicate with the Board?**

In accordance with the policy, approved by all of the Independent Directors, shareholders and other interested parties may communicate directly with the full Board, the Chairman of the Board, non-management Directors as a group or individual Directors, including the Lead Director, by delivering a written communication in care of the Corporate Secretary of SBS, 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, NM 87110. The written communication should be addressed to the specific Director or Directors whom the shareholder or interested party wishes to contact. Communications may be addressed to the Director(s) concerned, and forwarded to the Corporate Secretary at 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, NM 87110. All communications are recorded in a log, and the log is regularly submitted to the Board for review.

## **What is the Board's Policy Regarding Annual Meeting Attendance?**

As a matter of policy, Board members are required to attend the annual meeting of shareholders, unless absence is unavoidable due to matters outside the control of a Director. All members of the Board attended the last annual meeting of shareholders on November 13, 2003.

## **How are Directors Nominated?**

Among other duties, the Corporate Governance and Nominating Committee (the "CGNC") identifies and recommends to the Board individuals qualified to serve as Directors of the Company and on committees of the Board and advises the Board with respect to the composition of the Board and its committees. All Board members are elected annually by our shareholders, subject to the Board's right to fill vacancies in existing or new Director positions on an interim basis. Based on advice from the CGNC, each year the Board will recommend a slate of Directors to be presented for election at the annual meeting of shareholders.

In accordance with the policy adopted by the CGNC, the CGNC will give consideration to any director candidates recommended by shareholders or groups of shareholders holding five percent (5%) or more of the outstanding voting stock of the Company for a period of at least one year. The CGNC will also review nominations submitted by shareholders holding less than five percent (5%) or holding shares for less than one year, but is under no obligation to formally consider such nominations. In considering candidates submitted by shareholders, the CGNC will take into consideration the needs of the Board and the qualifications of the candidate. The CGNC's evaluation process does not vary based on whether or not a candidate is recommended by a shareholder.

To have a candidate considered by the CGNC, a shareholder must submit the recommendation in writing and must include the following information:

- The name of the shareholder or group of shareholders making the recommendation, and evidence of the person's or group's ownership of SBS stock, including the number of shares owned and the length of time of ownership;
- The name, age, business address and residence address of the candidate;
- The principal occupation or employment of the candidate;
- The number of shares of SBS stock owned by the candidate;
- The candidate's resume or a listing of his or her qualifications to be a Director of SBS;
- The candidate's consent to be named as a Director if selected by the CGNC, nominated by the Board and approved by the shareholders; and
- any other information relating to the person that would be required to be disclosed in a solicitation of proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, if the candidate had been nominated by or on behalf of the Board.

The shareholder recommendation and information described above must be sent by U.S. mail, postage prepaid, to the Board of Directors of SBS c/o Corporate Secretary, at 2400 Louisiana Blvd. NE, AFC Building 5, Suite 600, Albuquerque, NM 87110 and must be received by the Corporate Secretary not less than 210 days before the anniversary date of the Company's most recent annual meeting of shareholders.

In identifying and evaluating nominees for Director, the CGNC seeks to ensure that the Board possesses, in the aggregate, the strategic, managerial and financial skills and experience necessary to fulfill its duties and to achieve its objectives, and seeks to ensure that the Board is comprised of Directors who have broad and diverse backgrounds, possessing knowledge in areas that are of importance to SBS. The CGNC looks at each nominee on a case-by-case basis regardless of who recommended the nominee. In looking at the qualifications of each candidate to determine if his or her election would further the goals described above, the CGNC takes into account all factors it considers appropriate, which include strength of character, mature judgment, career specialization, relevant technical skills or financial acumen, diversity of viewpoint, and industry knowledge. In addition, the CGNC examines a candidate's specific experiences and skills in relation to the needs of the Board and SBS and the skills and experiences of current Board members. The Board believes that, to be recommended as a Director nominee, each candidate must:

- display the highest personal and professional ethics, integrity and values;
- have the ability to exercise sound business judgment;
- be accomplished in his or her respective field, and have broad experience at the administrative and/or policy-making level in business, government, education, technology or public interest;
- be independent of any particular constituency, be able to represent all shareholders of the Company and be committed to enhancing long-term shareholder value; and
- have sufficient time available to devote to activities of the Board and to enhance his or her knowledge of the Company's business.

The Board also believes the following qualities or skills are necessary for one or more Directors to possess:

- At least one Director should have the requisite experience and expertise to be designated as an "audit committee financial expert" as defined by applicable rules of the SEC.
- One or more of the Directors generally should be active or former chief executive officers of public companies or leaders of major complex organizations, including commercial, scientific, government, educational and other similar institutions.
- Directors should be selected so that the Board represents diverse backgrounds, experience and perspectives.

The CGNC identifies potential nominees by asking current Directors and executive officers to notify the CGNC if they become aware of persons meeting the criteria described above who may be available to serve on the Board. The CGNC also, from time to time, may engage firms that specialize in identifying Director candidates. As described above, the CGNC will also consider candidates recommended by shareholders.

Once a person has been identified by the CGNC as a potential candidate, the CGNC may collect and review publicly available information regarding the person to assess whether the person should be considered further. If the CGNC determines that the candidate warrants further consideration, the Chairman or another member of the CGNC contacts the person. Generally, if the person expresses a willingness to be considered and to serve on the Board, the CGNC requests information from the candidate, reviews the person's accomplishments and qualifications, including in light of any other candidates that the CGNC might be considering, and conducts one or more interviews with the candidate. In certain instances, CGNC members may contact one or more references provided by the candidate or may contact other members of the business community or other persons that may have greater first-hand knowledge

of the candidate's accomplishments. Current members of the Board will also be asked to interview a candidate for the Board and to provide input on whether such candidate is suitable for the position.

During fiscal year 2004, SBS has not paid any fee to any third party or third parties to identify or evaluate or assist in identifying or evaluating potential nominees.

The CGNC did not receive, by a date not later than the 210th calendar day before the date of release of this Proxy Statement to security holders in connection with the previous year's annual meeting, a recommended nominee from a security holder that beneficially owned more than 5% of the company's voting common stock for at least one year as of the date the recommendation was made, or from a group of security holders that beneficially owned, in the aggregate, more than 5% of SBS common stock.

### **How Much Are The Directors Paid?**

During the Board term commencing in November 2003, Directors who were not employees were paid an annual retainer of \$10,000 for service on the Board, and an additional retainer for Committee Chairpersons as follows: Audit Committee Chair \$5,000; Corporate Governance and Nominating Committee Chair \$2,500; and Management Development and Compensation Committee Chair \$2,500. The Lead Director was paid an annual retainer of \$2,500. Non-employee Directors were also paid a meeting fee of \$1,500 per Board meeting day, a meeting fee of \$750 per Committee meeting, and \$1,000 per travel day for any Board or Committee meeting. In addition, non-employee Directors were paid \$500 for each meeting of the Board or any Committee held telephonically. Expenses incurred in connection with attending Board and Committee meetings are reimbursed. Non-employee Directors were able to elect, under SBS' 1998 or 2000 Long-Term Equity Incentive Plans, to receive a portion of these payments in restricted shares of SBS' common stock or options to purchase shares of SBS' common stock subject to, and in accordance with, Section 16(b) of the Securities Exchange Act of 1934. In addition, each non-employee Director received an option for 11,500 shares of SBS' common stock upon election or appointment to the Board, and each year of service thereafter. This option consisted of an option for 5,000 shares under the terms of the 1993 Director and Officer Stock Option Plan and an option for 6,500 shares under the terms of the 1998 or 2000 Long-Term Equity Incentive Plans. The exercise price of all such options is the market price of SBS' common stock on the grant date as provided in the respective plan.

For the Board term commencing in November 2004, Directors who are not employees will be paid an annual retainer for service on the Board of \$25,000 and an annual grant of restricted shares of SBS Common Stock, the number of shares to be determined by dividing \$14,000 by the closing market price of SBS' Common Stock on the day prior to their election to the Board. The restricted shares vest one year from the date of grant and the trading restrictions will be removed equally over a three-year period. All other elements of the Director's compensation as described above will remain unchanged.

For the 2003/2004 term, each Director was granted on November 13, 2003, an option to purchase 6,500 shares under the terms of the 1998 Long-Term Equity Incentive Plan and an option to purchase 5,000 shares under the terms of the 1993 Director and Officer Stock Option Plan. The option grant to each Director from the 1998 Long-Term Equity Incentive Plan vests in one year from the date of grant, expires in ten years from the date of the grant, and has a purchase price per share of \$14.02, the closing market price of SBS common stock on the date of grant, in accordance with the terms of the Plan. The option grant to each Director from the 1993 Director and Officer Option Plan vests in one year from the date of grant, expires in five years from the date of grant, and has a purchase price per share of \$14.00, the closing market price of SBS common stock on the day prior to the date of grant, in accordance with the terms of this Plan.

For the 2003/2004 term, each Director received \$1,500 for attending three telephonic meetings at \$500 per meeting.

In addition, each Director elected on November 12, 2003, to receive his cash compensation either in cash, restricted shares of SBS common stock, or options to purchase SBS common stock, or a combination of these selections, as follows:

- Warren W. Andrews and Richard Szafranski each elected to receive an option grant to purchase 11,835 shares under the terms of the 1998 Long-Term Equity Incentive Plan. These grants, effective November 13, 2003, vest equally over the first three years from the date of grant, expire ten years from the date of grant, and have a purchase price per share of \$14.00, the closing market price of SBS common stock on the date of the election.
- Lawrence A. Bennigson elected to receive, and was granted on November 13, 2003, 3,750 restricted shares of SBS common stock valued at \$14.00 per share, the closing market price of SBS common stock on the date of the election in accordance with the terms of the 1998 Long-Term Equity Incentive Plan. These restricted shares vest one year from date of grant and the trading restriction on one-third of the shares is removed upon the completion of the 2003/2004 term. The trading restriction on the remaining shares is removed equally on the second and third anniversary of the grant.
- Peter D. Fenner elected to receive a combination of restricted shares of SBS common stock and an option to purchase SBS common stock. Mr. Fenner elected to receive, and was granted on November 13, 2003, 2,500 restricted shares of SBS common stock and an option to purchase 2,731 shares of SBS common stock. The restricted shares were valued at \$14.00 per share, the closing market price of SBS common stock on the date of the election in accordance with the terms of the 1998 Long-Term Equity Incentive Plan. The restricted shares vest one year from date of grant and the trading restriction on one-third of the shares is removed upon the completion of the 2003/2004 term. The trading restriction on the remaining shares is removed equally on the second and third anniversary of the grant. The option grant vests equally over the first three years from the date of grant, expires ten years from the date of grant, and has a purchase price per share of \$14.00 per share, the closing market price of SBS common stock on the date of the election.
- Alan F. White elected to receive a combination of cash and an option to purchase SBS common stock. Mr. White elected to receive, and was granted on November 13, 2003, \$15,000 cash compensation and an option to purchase 7,283 shares of SBS common stock. The option grant vests equally over the first three years from the date of grant, expires ten years from the date of grant, and has a purchase price per share of \$14.00, the closing market price of SBS common stock on the date of the election.
- Louis C. Golm received \$15,000 for his service on the Board through his resignation in April 2004.

Employees who are also Directors receive no additional compensation for serving as Directors.

We indemnify our Directors and Executive Officers to the fullest extent permitted by law so that they will be free from undue concern about personal liability in connection with their service to us. This is required under our Bylaws, and we have also signed agreements with each of those individuals contractually obligating us to provide this indemnification to them.

## **COMPENSATION OF EXECUTIVE OFFICERS**

### **Executive Officers Who Are Not Directors**

*Bruce E. Castle*, 46, was appointed Vice President, General Counsel and Secretary of SBS in November 2002. Mr. Castle was hired by SBS as General Counsel in July 2002. Before joining SBS, Mr. Castle practiced law in Albuquerque, New Mexico for 19 years, including as a director and shareholder of Kemp Smith Duncan & Hammond, P.C., managing shareholder of Eastham Johnson Monnheimer & Jontz, P.C., and most recently a principal of Vogel Campbell Blueher & Castle, P.C. Mr. Castle holds a Bachelor of Arts Degree from Northeast Missouri State University (now Truman State University) and a Juris Doctor Degree from the University of Missouri.

*James E. Dixon, Jr.*, 59, was appointed Executive Vice President in November 2001, and Treasurer and Chief Financial Officer in September 1995. From September 1995 to November 2001, Mr. Dixon held the position of

Vice President, Finance and Administration. In addition, Mr. Dixon served as Secretary from November 2000 until November 2002. Mr. Dixon served as a Director from November 1998 through November 2000. For eight years before joining SBS, Mr. Dixon held the position of Director of Finance, Howden Group America, Inc., a wholly owned subsidiary of Howden Group PLC. Howden Group America's subsidiaries, whose combined annual revenue then exceeded \$200 million, specialize in the design and manufacture of air and gas handling equipment, defense-related products and food processing equipment. Before that, Mr. Dixon held various controller positions at Westinghouse Electric Corporation from 1971 to 1985. Mr. Dixon holds a Bachelor's Degree in Business Education from Indiana University of Pennsylvania.

*David H. Greig*, 49, was appointed President and Chief Operating Officer in April 2002. From February 2001 to April 2002, Mr. Greig held the positions of Vice President of SBS and President of SBS' Commercial Group. Mr. Greig joined SBS in October 1997 as President of SBS' wholly owned subsidiary, SBS Technologies, Inc., Connectivity Products in St. Paul, Minnesota. Before joining SBS, Mr. Greig was employed by Perle Systems, a designer and manufacturer of computer networking equipment. During his fourteen-year tenure with Perle, Mr. Greig served in several capacities, including President of the Perle Customer Engineering Division, and later served simultaneously as President of Perle's U.S. operations, and Executive Vice President and Director of the Canadian parent company. Previously, Mr. Greig was Founder and President of Greig-Power Co. Ltd., a Toronto, Canada-based developer of custom electronic systems used to automate and control manufacturing operations. Mr. Greig performed duties as a research assistant at York University's Center for Research in Experimental Space Science before founding his own business. Mr. Greig holds the equivalent of a Bachelor's Degree in Electrical Engineering from Ryerson Polytechnical Institute in Toronto, Ontario, Canada.

### How Much Do The Executive Officers Get Paid?

The following table provides an overview of compensation that SBS paid to the Executive Officers for the fiscal years ended June 30, 2004, 2003 and 2002.

**SUMMARY COMPENSATION TABLE**

<b>Name and Principal Position</b>	<b>Year</b>	<b>Annual Compensation</b>		<b>Long-Term Compensation Awards</b>	<b>All Other Compensation (\$)</b>
		<b>Salary (\$)</b>	<b>Securities Underlying Options (# shares)</b>		
Clarence W. Peckham Chief Executive Officer (1)	2004	300,000	—	—	37,538 (5)
	2003	272,870	100,000	—	43,508 (6)
	2002	212,463	60,000	—	7,435 (7)
Christopher J. Amenson Chairman of the Board, Executive Chairman & Former Chief Executive Officer (2)	2004	150,000	—	—	6,000 (7)
	2003	192,335	—	—	9,291 (8)
	2002	62,154	120,000	—	5,849 (9)
David H. Greig President and Chief Operating Officer (3)	2004	282,615	—	—	332 (10)
	2003	275,000	30,000	—	48,835 (11)
	2002	232,489	110,000	—	—
James E. Dixon, Jr. Vice President, Chief Financial Officer & Treasurer	2004	282,615	20,000	—	14,582 (12)
	2003	275,000	—	—	8,253 (7)
	2002	257,618	60,000	—	7,287 (7)
Bruce E. Castle Vice President, General Counsel & Secretary (4)	2004	234,346	7,500	—	9,310 (13)
	2003	197,308	20,000	—	4,500 (7)

- (1) Effective April 17, 2003, Clarence W. Peckham was appointed to the position of Chief Executive Officer.
- (2) Effective April 17, 2003, Christopher J. Amenson was appointed to the position of Executive Chairman.
- (3) David H. Greig was appointed to the position of President and Chief Operating Officer effective April 26, 2002.
- (4) Bruce E. Castle was appointed Vice President, General Counsel and Secretary of SBS in November 2002.
- (5) Includes payment of \$28,846 for accrued leave compensation and \$8,692 made by SBS pursuant to a contribution-matching program under its 401 (K) plan.
- (6) Includes \$34,622 in relocation payments and \$8,886 in payments made by SBS pursuant to a contribution-matching program under its 401(k) plan.
- (7) Represents payments made by SBS pursuant to a contribution-matching program under its 401(k) plan. Amounts paid under SBS' other employee benefits plans are not included because the benefits provided to officers under these plans are identical to those provided to all other employees.
- (8) Includes \$7,692 made by SBS pursuant to a contribution-matching program under its 401(k) plan and \$1,599 in fringe benefits.
- (9) Includes \$2,486 made by SBS pursuant to a contribution-matching program under its 401(k) plan and \$3,363 in fringe benefits.
- (10) Represents \$332 in fringe benefits.
- (11) Represents relocation benefits paid to employee.
- (12) Includes \$5,699 for accrued leave compensation, \$8,448 made by SBS pursuant to a contribution-matching program under its 401 (K) plan, and \$435 in fringe benefits.
- (13) Includes \$8,310 made by SBS pursuant to a contribution-matching program under its 401 (K) plan, and \$1,000 in fringe benefits.

The following table provides information about shares acquired upon the exercise of stock options, and unexercised stock options held by, the Executive Officers in the Summary Compensation Table at June 30, 2004:

**AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR  
AND FISCAL YEAR END OPTION VALUES**

<u>Name</u>	<u>Shares Acquired on Exercise</u>	<u>Value Realized</u>	<u>Number of Shares Underlying Unexercised Options at June 30, 2004</u>		<u>Value of Unexercised In-The-Money Options at June 30, 2004</u>	
			<u>Exercisable</u>	<u>Unexercisable</u>	<u>Exercisable</u>	<u>Unexercisable</u>
C. Amenson	—	\$ —	270,000	—	\$524,320	\$ —
C. Peckham	—	—	139,000	105,000	553,125	746,025
D. Greig	71,900	532,492	155,100	74,000	303,307	383,650
J. Dixon Jr.	50,000	420,972	117,000	50,000 (1)	189,605	219,025
B. Castle	—	—	5,000	22,500 (2)	40,350	167,325

- 
- (1) 10,000 of these options became exercisable August 11, 2004.
  - (2) 5,000 of these options became exercisable July 31, 2004, and 3,750 became exercisable August 11, 2004.

The following table provides information about individual grants of stock options made to the Executive Officers in the Summary Compensation Table during the year ended June 30, 2004:

#### **OPTION GRANTS IN FISCAL YEAR 2004**

<u>Name</u>	<u>Number of Securities Underlying Options Granted</u>	<u>Percent of Total Options Granted to Employees in Fiscal Year</u>	<u>Exercise Price Per Share</u>	<u>Expiration Date</u>	<u>Grant Date Present Value</u>
J. Dixon Jr.	20,000 (1)	3.42%	\$ 9.90	8/11/2013	\$ 94,657 (3)
B. Castle	7,500 (2)	1.28%	9.90	8/11/2013	37,496 (3)

- (1) Options were granted under the 2000 Long-Term Equity Incentive Plan; 10,000 per year become exercisable upon continuous employment beginning August 11, 2004 through August 11, 2005, and the option expires on August 11, 2013.
- (2) Options were granted under the 2000 Long-Term Equity Incentive Plan; 3,750 per year become exercisable upon continuous employment beginning August 11, 2004 through August 11, 2005, and the option expires on August 11, 2013.
- (3) Estimated using the Black-Scholes option pricing model with the following weighted average assumptions; expected life of 2.64 years, risk free rate of return of 2.18%, expected volatility of 76.47% and a dividend yield of 0%.

#### **Compensation Plans of SBS Under Which Securities May Be Issued**

The following sets forth certain information as of June 30, 2004 with respect to compensation plans of SBS under which securities may be issued:

#### **EQUITY COMPENSATION PLAN INFORMATION**

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, rights, restricted stock, and other stock-based awards</u>	<u>Weighted-average exercise price of outstanding options, rights, restricted stock, and other stock-based awards</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)</u>
Equity compensation plans approved by security holders	2,952,505	\$14.91	2,794,638 *
Equity compensation plans not approved by security holders	—	—	—
Total	<u>2,952,505</u>	<u>\$14.91</u>	<u>2,794,638 *</u>

\* Certain equity compensation plans of the Company contain a formula that automatically increases the number of securities available for issuance by a percentage of the number of outstanding securities of the Company as follows:

- the 1993 Director and Officer Stock Option Plan provides securities available for grant equal to 5% of the number of shares of the Company's common stock outstanding the first day of each fiscal year plus shares underlying expired or terminated options (1,405,824 shares available at June 30, 2004).
- the 2000 Long-Term Equity Incentive Plan provides securities available for grant equal to ten percent of the adjusted average of the outstanding stock, as that number is determined by SBS to calculate net income per common share – assuming dilution for the preceding fiscal year, reduced by any shares of stock under the plan subject to unexercised options and any shares of stock under the plan subject to restrictions (452,921 shares available at June 30, 2004).

In addition, the 1998 Long-Term Equity Incentive Plan provides for the award of restricted stock, stock appreciation rights, and stock unit awards, in addition to options, up to the number of shares remaining in the Plan (798,893 available as of June 30, 2004). The 2000 Long-Term Equity Plan also provides for restricted stock awards and restricted stock unit awards, not to exceed a total of 50,000 shares in any one year.

### **Does SBS Have Employment Agreements For The Executive Officers?**

All of our Executive Officers have employment agreements with SBS.

Each Agreement:

- assigns to SBS certain intellectual property developed by the employee on SBS time,
- is terminable by either party, with or without cause, upon thirty days' notice,
- contains non-competition clauses which apply during the employment period and for two years thereafter, and
- contains restrictions against disclosure of proprietary information.

Christopher J. Amenson serves as Executive Chairman under an employment agreement executed on April 17, 2003. Under the agreement, which has a two-year term unless terminated as described below, Mr. Amenson receives a current base annual salary of \$150,000. The agreement provides that, upon either voluntary or involuntary resignation, SBS will employ Mr. Amenson for two years following termination as an advisor to the Board of Directors at an annual rate of pay of \$40,000. Also, the agreement provides for six months' severance payable upon Mr. Amenson's termination by SBS without cause.

Bruce E. Castle serves as Vice President, General Counsel and Secretary pursuant to an employment agreement effective July 29, 2003. Under the agreement, which has a three-year term unless terminated as described below, Mr. Castle receives a current base annual salary of \$238,500. Also, the agreement provides for six months' severance payable upon Mr. Castle's termination by SBS without cause and one-year severance payable upon Mr. Castle's termination without cause within one year after a change in control of SBS.

James E. Dixon, Jr. serves as Executive Vice President, Treasurer and Chief Financial Officer pursuant to an employment agreement effective July 29, 2003. Under the agreement, which has a three-year term unless terminated as described below, Mr. Dixon receives a current base annual salary of \$286,000. Also, the agreement provides for six months' severance payable upon Mr. Dixon's termination by SBS without cause and one-year severance payable upon Mr. Dixon's termination without cause within one year after a change in control of SBS.

David H. Greig serves as President and Chief Operating Officer pursuant to an employment agreement effective July 29, 2003. Under the agreement, which has a three-year term unless terminated as described below, Mr. Greig receives a current base annual salary of \$286,000. Also, the agreement provides for six months' severance payable upon Mr. Greig's termination by SBS without cause and one-year severance payable upon Mr. Greig's termination without cause within one year after a change in control of SBS.

Clarence W. Peckham serves as Chief Executive Officer pursuant to an employment agreement effective April 17, 2003. Under the agreement, which has a five-year term unless terminated as described below, Mr. Peckham receives a current base annual salary of \$300,000. The agreement also provides for issuance to Mr. Peckham of a stock option grant of 100,000 shares of SBS common stock, with annual vesting of 20,000 shares beginning on April 30, 2004 through April 30, 2008, based on continuous employment through these dates. Also, the agreement provides for six months' severance payable upon Mr. Peckham's termination by SBS without cause and one-year severance payable upon Mr. Peckham's termination without cause within one year after a change in control of SBS.

## **REPORTABLE TRANSACTIONS**

**During The Last Fiscal Year, Has Any Director, Officer, Nominee For Director, Or Shareholder Identified In The Ownership Of SBS Common Stock Section, Or Any Of Their Immediate Family Members, Been Involved In Any Transaction In Which SBS Or Any Of Its Subsidiaries Was Involved, Or May Be Involved In The Future, Which Exceeded \$60,000?**

SBS knows of no reportable transactions.

## **SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

**Did The Directors And Executive Officers File All Of Their Required Section 16(a) Beneficial Ownership Reports With The SEC On Time?**

Under the Securities Exchange Act of 1934, Directors and Executive Officers of public companies are required to report to the Securities and Exchange Commission all personal transactions involving SBS' common stock. Based solely upon a review of Forms 3 and 4 filed by Directors and Executive Officers of SBS during the fiscal year ended June 30, 2004, all reports required by Section 16(a) of the Securities Exchange Act of 1934 were timely filed.

## **INDEPENDENT PUBLIC ACCOUNTANTS**

### *Approval of Services*

The Audit Committee of the Board of Directors pre-approves all engagements for audit and non-audit services provided by the Company's independent registered public accounting firm, KPMG LLP. The policies and procedures for approval of all services as outlined in the Audit Committee charter follow:

- The Audit Committee shall serve as the sole authority to which the independent registered public accountants are accountable, and have the sole authority and responsibility for the appointment, compensation, retention and oversight of the work of the independent registered public accountants, including any non-audit relationship with the independent registered public accountants; and
- The Audit Committee shall select and retain (subject to approval by the Company's shareholders), and terminate when appropriate, the independent registered public accountants, set the independent registered public accountants compensation, and pre-approve all audit services to be provided by the independent registered public accountants; and
- The Audit Committee shall pre-approve all permitted non-audit services to be performed by the independent registered public accountants and establish policies and procedures for the engagement of the independent registered public accountants to provide permitted non-audit services.

In addition, the Audit Committee has determined that the Audit Committee on behalf of SBS shall not engage the independent registered public accountants to perform any services for SBS other than audit, tax compliance, tax planning and tax advice.

The aggregate fees billed during the fiscal years ended June 30, 2004 and 2003 for professional services rendered by SBS' independent registered public accounting firm, KPMG LLP, all of which were pre-approved by the Audit Committee, were as follows:

<b>Type of Service</b>	<b><u>For fiscal years ended June 30,</u></b>			
	<b><u>2004</u></b>	<b><u>%</u></b>	<b><u>2003</u></b>	<b><u>%</u></b>
Audit fees	\$ 335,500	37%	\$ 361,500	35%
Audit-related fees	11,900	1%	18,400	2%
Tax fees				
Tax compliance	424,600	47%	375,700	37%
Tax advice and planning	125,700	14%	257,900	25%
Total tax fees	550,300	61%	633,600	62%
All other fees	1,800	1%	5,400	1%
Total fees	<u>\$ 899,500</u>	<u>100%</u>	<u>\$ 1,018,900</u>	<u>100%</u>

#### *Audit Fees*

Audit fees are comprised of fees billed in connection with: the audit of the Company's consolidated financial statements included in Form 10-K; the review of the Company's unaudited interim condensed consolidated financial statements included in Form 10-Q; statutory audits of certain foreign subsidiaries; and fees for services related to procedures performed to fulfill KPMG's responsibilities under generally accepted auditing standards in the United States of America. Audit fees also include fees associated with the review by KPMG of registration statements filed with the Securities and Exchange Commission and the related issuance of independent accountant consent letters.

#### *Audit Related Fees*

Audit related fees include assurance and related fees billed in connection with the audit of employee benefit plan financial statements and due diligence assistance services completed on potential acquisitions.

#### *Tax Fees*

Tax fees are comprised of fees billed in connection with tax compliance services and fees billed in connection with tax advice and tax planning services. Tax compliance services include preparation of income tax returns and filings with tax authorities based in the United States, Germany and Canada, assistance with claims for refunds, and tax payment assistance. Tax advice and tax planning services include assistance with the examination of tax returns previously filed, the implementation of domestic and international tax planning strategies, and consultation on other tax matters.

#### *All Other Fees*

All other fees include fees billed for assistance with the interpretation of new accounting standards and other related services.

### **REPORT OF THE AUDIT COMMITTEE**

The Audit Committee of the Board of Directors is comprised of three Directors who are each independent and financially literate, and all of whom are financially sophisticated, within the current meaning of the National Association of Securities Dealers' ("NASD") rules regarding audit committees. Our Board of Directors has determined that Peter D. Fenner is an "audit committee financial expert," as defined by SEC rules.

We have reviewed and discussed SBS' audited consolidated financial statements for the fiscal year ended June 30, 2004, with management, which has primary responsibility for the financial statements. KPMG LLP, our company's independent registered public accountants for 2004, is responsible for expressing an opinion as to whether our consolidated financial statements present fairly, in all material respects, our financial position, results of

operations, and cash flows in conformity with U.S. generally accepted accounting principles. The committee has discussed with KPMG LLP the matters that are required to be discussed by Statement on Auditing Standards No. 61 (Communication With Audit Committees) and No. 90 (Audit Committee Communications), issued by the Auditing Standards Board of the American Institute of Certified Public Accountants. KPMG LLP has provided to the committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and the committee discussed with KPMG LLP the firm's independence from SBS. In addition, the committee has considered whether the provision of the non-audit services that it has approved is compatible with maintaining KPMG LLP's independence and believes that it is.

Based on these reviews and discussions, the committee has recommended to SBS' Board of Directors that SBS' audited consolidated financial statements be included in SBS' Annual Report on Form 10-K for the year ended June 30, 2004, and selected KPMG LLP as our independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005, subject to shareholder ratification.

Audit Committee

Peter D. Fenner, Chairman  
Lawrence A. Bennigson  
Warren W. Andrews

The Report of the Audit Committee does not constitute soliciting material, and shall not be deemed to be filed or incorporated by reference into any other SBS filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates the Report of the Audit Committee by reference therein.

**REPORT OF THE MANAGEMENT DEVELOPMENT AND COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION**

The Management Development and Compensation Committee of the Board of Directors is comprised entirely of outside Directors. Members are not eligible to participate in the officer and employee compensation programs they oversee.

The responsibility of the Management Development and Compensation Committee is to:

- review the Chief Executive Officer's policies and procedures designed to attract, develop and retain key managers and executives critical to the success of SBS and align executive compensation with shareholder interests, and to make related recommendations to the Board of Directors,
- provide guidance and overview of all management development, executive salary, incentive and benefit programs,
- evaluate the performance of the Chief Executive Officer and recommend Chief Executive Officer compensation to the full Board, and
- meet annually with the Chief Executive Officer to review management development programs and activities, and succession planning.

While the administration of management development and compensation is the responsibility of SBS management, the review and approval of the Management Development and Compensation Committee is required for:

- overall executive (individuals which lead businesses or functional responsibilities) compensation, philosophy and policy,
- incentive programs,
- executive benefit and perquisite programs,
- stock and stock option awards and their terms to be awarded to officers subject to Section 16(b) of the Securities Exchange Act of 1934, and

- Board member compensation and any other compensation issues as may be directed to it.

**Chief Executive Officer Compensation Policy:**

In June of 2000, the Management Development and Compensation Committee recommended and the Board adopted the policy that future primary incentive compensation for the Chief Executive Officer would be based on stock options, more closely aligning the Chief Executive Officer's compensation with the interests of SBS' shareholders. In addition, the Board adopted the policy that the Chief Executive Officer would be eligible for cash incentives, at the sole discretion of and approval by the Committee. Factors in determining whether any cash incentive would be paid to the Chief Executive Officer include:

- SBS' financial operating performance as compared with its approved fiscal operating plan,
- progress in the development of management and other human resources within SBS, and
- progress in corporate development.

*Chief Executive Officer Compensation (Mr. Peckham).* Clarence W. Peckham was appointed to the position of Chief Executive Officer effective April 17, 2003, succeeding Christopher J. Amenson, who assumed the position of Executive Chairman effective the same date. Mr. Peckham entered into a five-year employment agreement with a base salary of \$300,000 and was granted stock options for 100,000 shares of SBS common stock, with annual vesting of 20,000 shares beginning on April 30, 2004 through April 30, 2008, based on continuous employment through these dates. Mr. Peckham's level of compensation is consistent with that of similar positions of companies of similar size in the electronics and other relevant industries, as well as market competitive conditions to attract high quality leadership in SBS' industry. At the sole discretion of the Management Development and Compensation Committee, Mr. Peckham is eligible to receive additional cash incentive compensation. No cash incentive compensation was paid to him in fiscal 2004.

*Executive Chairman Compensation (Mr. Amenson).* Christopher J. Amenson was appointed Chief Executive Officer on April 26, 2002, and held that position until April 17, 2003, when he assumed the position of Executive Chairman. Under Mr. Amenson's current employment agreement executed on April 17, 2003, which has a two-year term, Mr. Amenson receives a current base annual salary of \$150,000. Mr. Amenson's level of compensation is consistent with his duties assigned by the Board of Directors and Mr. Amenson's level of experience and expertise. No incentive options or cash incentive compensation were provided to him in fiscal 2004.

**Executive Officer Compensation Policy:**

Base salaries for all other executive officers have been set at competitive levels by the Chief Executive Officer in consultation with the Management Development and Compensation Committee, giving due regard to individual performance and time in position. Cash incentive compensation for all other executive officers is discretionary, proposed by the Chief Executive Officer, and approved by the Committee, based on factors similar to those used for establishing cash incentive compensation for the Chief Executive Officer. Factors included in determining discretionary cash incentive compensation for management with line responsibility for division operations are generally tied to performance targets for the businesses under their authority and contribution to overall earnings per share. These performance targets are set as part of the annual budgeting process for SBS and its subsidiaries. No cash incentive compensation was paid during the fiscal year ended June 30, 2004.

Management Development and  
Compensation Committee

Lawrence A. Bennigson, Chairman  
Richard Szafranski  
Alan F. White

## **REPORT OF THE CORPORATE GOVERNANCE AND NOMINATING COMMITTEE**

The Corporate Governance and Nominating Committee (the Committee) is a standing committee of the Board of Directors of SBS and is created by the Bylaws of SBS. The Committee is comprised entirely of Independent Directors.

The Committee reviewed and approved the Corporate Governance section of this Proxy Statement. All Director nominations contained in this Proxy Statement have been performed in accordance with the Director nomination process described in this Proxy Statement.

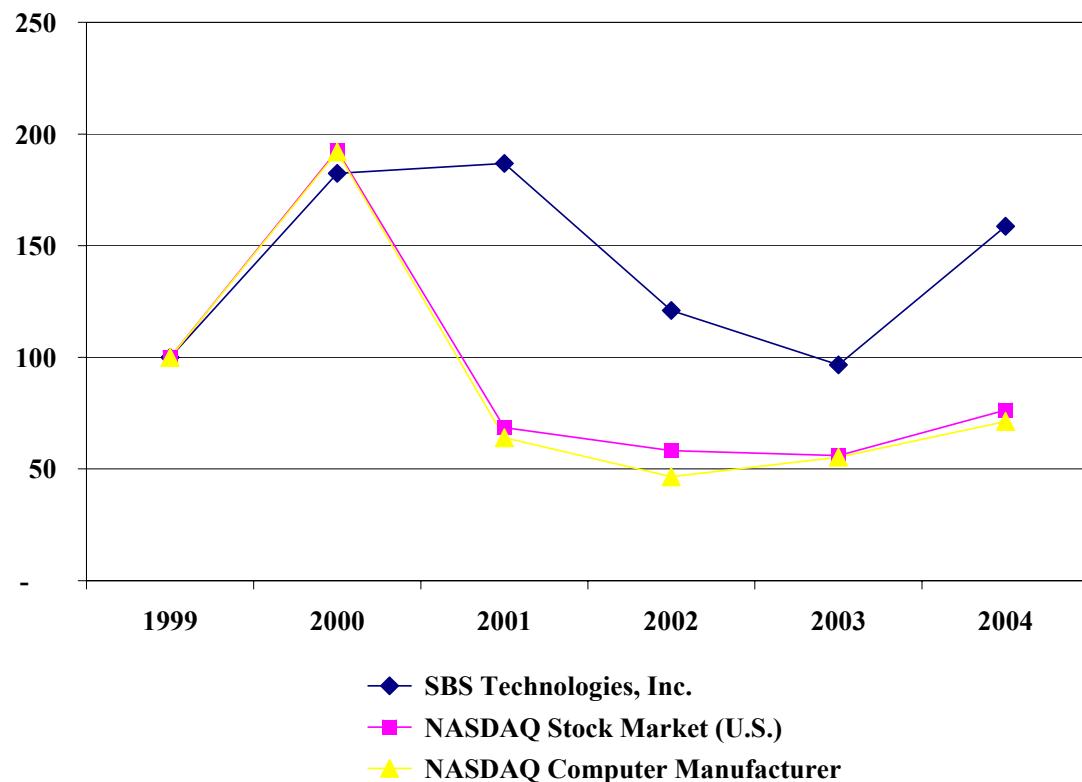
Corporate Governance and Nominating Committee

Alan F. White, Chairman  
Warren W. Andrews  
Peter D. Fenner  
Richard Szafranski

## FIVE YEAR PERFORMANCE COMPARISON

### How Did SBS Common Stock Perform During the Fiscal Year?

The graph below provides a comparison of SBS' cumulative total shareholder return with performances of the NASDAQ Stock Market (U.S.) Index and the NASDAQ Computer Manufacturer Index as a Peer Group. The following graph assumes the investment of \$100 on June 30, 1999 in SBS common stock. The NASDAQ Computer Manufacturer Index's and the NASDAQ Stock Market (U.S.) Index's returns assume reinvestment of stock and cash dividends.



	June 30, 1999	June 30, 2000	June 30, 2001	June 30, 2002	June 30, 2003	June 30, 2004
SBS Technologies, Inc.	100	182.41	186.86	120.98	96.69	158.72
NASDAQ Stock Market (U.S.)	100	192.65	68.58	58.24	56.04	76.42
NASDAQ Computer Manufacturer	100	192.00	63.98	46.53	55.33	71.30

- \$100 invested on June 30, 1999 in stock or index — including reinvestment of dividends. Fiscal year ended June 30.

## ANNUAL REPORT

The Annual Report to Shareholders concerning the operations of SBS for fiscal year ended June 30, 2004, including the financial statements for that year, has been enclosed with this Proxy Statement.

## **PROPOSALS TO BE VOTED UPON**

### **PROXY ITEM NO. 1 — ELECTION OF DIRECTORS**

SBS' Bylaws provide for a Board of Directors composed of a minimum of one but not more than nine Directors, all of whom are elected annually. The Board of Directors determines on an annual basis the number of nominees to be recommended to the Shareholders for election to the Board which, for this year, is seven. The following persons have consented to be nominated and, if elected, to serve as Directors of SBS.

- |                           |                        |
|---------------------------|------------------------|
| 1. Christopher J. Amenson | 5. Clarence W. Peckham |
| 2. Warren W. Andrews      | 6. Richard Szafranski  |
| 3. Lawrence A. Bennigson  | 7. Alan F. White       |
| 4. Peter D. Fenner        |                        |

**The Board of Directors recommends that you vote "FOR" the election of each named nominee.**

### **PROXY ITEM NO. 2 — RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Directors have selected KPMG LLP as SBS' independent registered public accountants to audit the consolidated financial statements for the fiscal year ending June 30, 2005. KPMG LLP has no direct interest in SBS and has had no such interest during the past fiscal year. Representatives of KPMG LLP will be present at the Annual Meeting of Shareholders, will be given the opportunity to make a statement if they so wish, and will be available to respond to appropriate questions.

**The Board of Directors recommends that you vote "FOR" the ratification of their selection of KPMG LLP as independent registered public accountants of SBS.**

## **OTHER MATTERS**

The Board of Directors is not aware of any other matters that are to be presented at the meeting. However, if any other matters should properly come before the meeting, the Proxies will vote on those matters in accordance with their judgment.

The above Notice and Proxy Statement are sent by order of the Board of Directors.



Bruce E. Castle  
*Secretary*

## **Appendix A**

### **SBS Technologies, Inc. Audit Committee**

#### **CHARTER**

Revised June 10, 2004

#### **Status**

The Audit Committee is a committee of the Board of Directors.

#### **Membership**

The Audit Committee shall consist of three or more directors elected by the Board of Directors at the recommendation of the Corporate Governance and Nominating Committee, each of whom in the judgment of the Board of Directors shall be independent in accordance with the requirements of the Securities and Exchange Commission (“SEC”) and listing standards for The Nasdaq Stock Market, Inc. (“Nasdaq”). Each member shall in the judgment of the Board of Directors have the ability to read and understand fundamental financial statements, including a company’s balance sheet, income statement and cash flow statement.

At least one member of the Audit Committee shall in the judgment of the Board of Directors be an audit committee financial expert in accordance with the requirements of the SEC and at least one member (who may also serve as the audit committee financial expert) shall in the judgment of the Board of Directors have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities in accordance with Nasdaq listing standards.

#### **Purpose**

The Audit Committee shall oversee the accounting and financial reporting processes and the audit of the financial statements of the Company, including (a) the integrity of the Company's financial statements and internal control over financial reporting, (b) the Company's compliance with legal and regulatory requirements, (c) the qualifications and independence of the independent auditor, and (d) the performance of the independent auditor. The Audit Committee shall serve as the sole authority to which the independent auditor is accountable, and have the sole authority and responsibility for the appointment, compensation, retention and oversight of the work of the independent auditor, including any non-audit relationship with the independent auditor.

#### **Responsibilities**

1. Select and retain (subject to approval by the Company's stockholders), and terminate when appropriate, the independent auditor, set the independent auditor's compensation, and pre-approve all audit services to be provided by the independent auditor.
2. Pre-approve all permitted non-audit services to be performed by the independent auditor and establish policies and procedures for the engagement of the independent auditor to provide permitted non-audit services.
3. At least annually, receive and review: (a) a report by the independent auditor describing the independent auditor's internal quality-control procedures and any material issues raised by the most recent internal quality-control review, or peer review, of the independent auditing firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent

audits carried out by the firm, and any steps taken to deal with any such issues; and (b) other required reports from the independent auditor.

4. At least annually, (a) consider the independence of the independent auditor, including whether the provision by the independent auditor of permitted non-audit services is compatible with independence, (b) obtain and review a formal written statement from the independent auditor delineating all relationships between the auditor and the Company consistent with Independence Standards Board Standard 1, (c) actively engage in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor, and (d) take, or recommend that the Board of Directors take, appropriate action to oversee the independence of the independent auditor.
5. Review with the independent auditor in connection with its audit: (a) the independent auditor's audit plan, (b) the scope and results of the audit; (c) any problems or difficulties that the independent auditor encountered in the course of the audit work, and management's response; and (d) any questions, comments or suggestions the independent auditor may have relating to internal control over financial reporting, and accounting practices and procedures, of the Company.
6. Review with the independent auditor and management: (a) the adequacy and effectiveness of the Company's accounting practices, disclosure controls and procedures (and management reports thereon), and internal control over financial reporting, including:
  - any significant deficiencies or material weaknesses and significant changes in internal control over financial reporting reported by the independent auditor or management,
  - the suitability of the control framework on which management's evaluation is based,
  - any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.
7. Review with management and the independent auditor the annual financial statements of the Company included in the Company's Form 10-K, as well as information outside of the financial statements including: (a) the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations"; (b) any material changes in accounting principles or practices used in preparing the financial statements prior to the filing of a report on Form 10-K with the SEC; and (c) the items required by Statement of Auditing Standards No. 61 as in effect at that time.
8. Review quarterly earnings press releases and attached financial statements prior to being released to the public, as well as Company policies with respect to earnings press releases, financial information and earnings guidance provided to analysts and rating agencies.
9. Discuss Company policies with respect to risk assessment and risk management, and review contingent liabilities and risks that may be material to the Company and major legislative and regulatory developments which could materially impact the Company's contingent liabilities and risks.
10. Review: (a) the status of compliance with laws, regulations, and internal procedures, including management conflicts of interest and adherence to standards of business conduct as required by the policies of the Company; and (b) the scope and status of systems designed to promote Company compliance with laws, regulations and internal procedures.
11. Establish procedures for the confidential and anonymous receipt, retention and treatment of complaints regarding the Company's accounting, internal control and auditing matters.
12. Establish policies for the hiring of employees and former employees of the independent auditor.

13. Obtain the advice and assistance, as appropriate, of independent counsel and other advisors as necessary to fulfill the responsibilities of the Audit Committee, and conduct investigations, with or without the assistance of such counsel or advisors, appropriate to fulfilling the Audit Committee's responsibilities.
14. Provide on behalf of the Company appropriate funding for (a) compensation to any registered public accounting firm, including the independent auditor, providing services to the Company, (b) compensation to any independent counsel or other advisors retained under paragraph 13 above, and (c) necessary or appropriate ordinary administrative expenses of the Audit Committee in carrying out its duties.
15. Conduct an annual performance evaluation of the Audit Committee and annually evaluate the adequacy of its charter.
16. Perform any other activities consistent with this Charter, the Company's Bylaws and governing law as the Committee or the Board deems necessary or appropriate.

### **Meetings**

The Audit Committee shall meet at least five times per year and more frequently as circumstances require. The Audit Committee shall periodically meet separately in executive session, with management and the independent auditor, and with the independent auditor without management present. The Audit Committee shall report regularly to the Board of Directors.

Unless a Chairman is elected by the full Board of Directors, the members may designate a Chairman by majority vote of the full membership of the Audit Committee. A majority of the entire Audit Committee shall constitute a quorum for the transaction of business. The action of a majority of the members present at a meeting at which a quorum is present shall be the action of the Audit Committee. Any action required or permitted to be taken at a meeting of the Audit Committee may be taken without a meeting by the unanimous written consent of all members of the Audit Committee. The Audit Committee may establish such other rules of procedure for its business as it deems desirable.

### **Report**

The Audit Committee shall prepare a report to include in the Company's annual Form 10-K and/or proxy statement.

## **Appendix B**

### **SBS Technologies, Inc. Corporate Governance and Nominating Committee**

#### **CHARTER**

##### **STATEMENT OF PURPOSE**

The Corporate Governance and Nominating Committee (“Committee”) is a standing committee of the Board of Directors (the “Board”) of SBS Technologies, Inc. (the “Company”), consisting of not fewer than three independent directors. The Committee shall have the responsibility to make recommendations to the Board with respect to nominees to be designated by the Board for election as directors and officers, the effectiveness, structure, size and composition of the Board, including committee assignments, and to monitor corporate governance standards of the Company.

The Committee will periodically review its charter and recommend appropriate changes to the Board. The Committee may retain independent consultants, as appropriate, and take such other actions as may be necessary to achieve the following duties and responsibilities:

##### **DUTIES AND RESPONSIBILITIES**

1. Develop candidate criteria for Board membership, including at least one “financial expert” pursuant to SEC guidelines.
2. Recommend to the Board nominees for election to the Board.
3. Recommend to the Board nominees for election as officers of the Company.
4. Recommend to the Board the composition and organization of the Board, including committee assignments.
5. Recommend to the Board the optimal size of the Board.
6. Review Board policies and practices that influence the effectiveness of the Board, including conflicts of interest.
7. Recommend development programs and activities for Board members and oversee orientation of new Board members.
8. Recommend criteria to be applied in determining whether directors should continue in office, and periodically review the performance of directors.
9. Periodically review Company policies and procedures with respect to corporate governance standards, including the nature, timeliness and adequacy of information supplied to directors regarding Company activities, industry trends and public policy developments.
10. Recommend Board stock ownership guidelines.

Dated: April 20, 2004

## **Appendix C**

### **SBS Technologies, Inc. Management Development and Compensation Committee**

#### **CHARTER**

The Management Development and Compensation Committee of the Board of Directors is comprised entirely of outside Directors. Members are not eligible to participate in the officer and employee compensation programs they oversee. The responsibility of the Management Development and Compensation Committee is to:

- review the CEO's policies and procedures designed to attract, develop and retain key managers and executives critical to the success of SBS and to align executive compensation with shareholder interests, and to make related recommendations to the Board of Directors,
- provide guidance and overview of all management development, executive salary, incentive and benefit programs,
- evaluate the performance of the Chief Executive Officer and to recommend Chief Executive Officer compensation to the full Board, and
- meet annually with the Chief Executive Officer to review management development programs and activities, and succession planning.

While the administration of management development and compensation is the responsibility of SBS management, the review and approval of the Management Development and Compensation Committee is required for:

- overall executive (individuals which lead businesses or functional responsibilities) compensation, philosophy and policy,
- incentive programs,
- executive benefit and perquisite programs,
- stock and stock option awards and their terms to be awarded to officers subject to Section 16(b) of the Securities Exchange Act of 1934, and
- Board member compensation and any other compensation issues as may be directed to it.

Dated: February 7, 2003

**Annual Report on FORM 10-K**

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

---

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2004

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-10981



**SBS Technologies, Inc.**

(Exact name of registrant as specified in its charter)

**New Mexico**

(State or other jurisdiction of  
incorporation or organization)

**85-0359415**

(IRS Employer  
Identification Number)

**2400 Louisiana Blvd. NE, AFC Bldg 5, Suite 600**

**Albuquerque, New Mexico**

(Address of principal executive office)

**87110**

(Zip code)

**Registrant's telephone number, including area code: (505) 875-0600**

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

Common Stock, no par value  
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [✓] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [✓] No [ ]

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on August 25, 2004 as reported on The Nasdaq Stock Market® was \$107,364,688. Shares of Common Stock held by each officer and director as of August 25, 2004 and by each person who owns 5% or more of the outstanding Common Stock according to filings with the Securities and Exchange Commission dated June 30, 2004 have been excluded because these persons may be deemed to be affiliates.

As of August 25, 2004, Registrant had 15,503,774 shares of Common Stock outstanding.

---

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's Proxy Statement for the registrant's 2004 Annual Meeting of Shareholders to be held November 18, 2004 are incorporated by reference into Part III of this Form 10-K.

---

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**FORM 10-K FOR THE YEAR ENDED JUNE 30, 2004**

**TABLE OF CONTENTS**

	<u>Page</u>
<b>PART I</b>	
Forward Looking Statements .....	1
Item 1. Business .....	2
Item 2. Properties .....	14
Item 3. Legal Proceedings .....	15
Item 4. Submission of Matters to a Vote of Security Holders.....	16
<b>PART II</b>	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.....	16
Item 6. Selected Financial Data.....	17
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	18
Item 7A. Quantitative and Qualitative Disclosures About Market Risk .....	33
Item 8. Financial Statements and Supplementary Data .....	33
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure .....	59
Item 9A. Controls and Procedures .....	59
Item 9B. Other Information.....	60
<b>PART III</b>	
Item 10. Directors and Executive Officers of the Registrant .....	60
Item 11. Executive Compensation.....	60
Item 12. Security Ownership of Certain Beneficial Owners and Management.....	60
Item 13. Certain Relationships and Related Transactions .....	60
Item 14. Principal Accounting Fees and Services .....	60
<b>PART IV</b>	
Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.....	61

## **FORWARD-LOOKING STATEMENTS**

This Form 10-K contains forward-looking statements with respect to the financial condition, results of operations and business of SBS Technologies, Inc. and subsidiaries (referred to variously as "SBS," the "Company," "we," "us" and "our"). You may find many of these statements by looking for words like "intends," "expects," "projects," "believes," "anticipates" or similar expressions in this Form 10-K. These forward-looking statements include:

- statements regarding future events and the future financial performance of SBS;
- expected sales and gross margin levels for the fiscal year ending June 30, 2005;
- expected sales levels for the quarter ending September 30, 2004;
- expectations of internally-generated cash flows;
- the continued health of the end markets we serve;
- the expectation of several government systems design wins to start production in fiscal year 2005;
- the expectation of sales to Applied Materials and Ericsson to continue during fiscal year 2005 at the same dollar level as in fiscal year 2004; and
- new product and business development efforts.

These statements are based upon certain assumptions and assessments made by the Company in light of our experience and our perception of historical trends, current conditions, expected future developments and other factors we believe to be appropriate. These assumptions and assessments include the volume and product mix of sales, estimates of costs and inventory and receivable levels based on preliminary information, and other items.

The forward-looking statements included in this document are subject to a number of risks, uncertainties, and other factors. Among these factors are:

- business and economic conditions generally affecting our customers and their end customers, including but not limited to the changes in size and program priorities of military procurement budgets, which may be less favorable than we expect, resulting in lower sales and earnings;
- a high degree of uncertainty and rapid change in the markets addressed by our products that could reduce sales or render certain SBS products obsolete, resulting in reduced gross profit levels;
- customer demand for and acceptance of our products, which may be less than we expect, affecting both sales and margins;
- our ability to design, test and introduce new products on a timely basis, which, if we are not able, may decrease both sales and margins;
- the other risk factors listed under "Risk Factors" included elsewhere in this Form 10-K.

Because forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by them. SBS cautions you not to place undue reliance on these statements, which speak only as of the date of this Form 10-K.

SBS does not undertake any obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## PART I

### Item 1. *Business*

#### *Introduction*

We design and build open-architecture embedded computer products that enable original equipment manufacturers (OEM) to serve the government, commercial, and communications end markets. Embedded computer products are put inside or made part of larger systems to process information, control machines, move computer data between machines, and interact with people. The companies that use our products manufacture very sophisticated, expensive devices, for example, MRI machines, flight simulators, wireless networks, fighter jets and industrial robots.

The SBS product line is strategically focused on embedded computing, and we serve virtually all parts of the market. We currently list more than 450 products in the product section of our website, [www.sbs.com](http://www.sbs.com). We offer components like input/output (I/O) modules, bus adapters, carrier cards, system enclosures, FPGA boards and single board computers, as well as network switches, blades and fully integrated systems. Many of these products are available in ruggedized versions, which can operate in conditions of extreme temperature, vibration, shock and humidity.

We serve a broad range of customers. We help our customers get to market faster, more reliably and more economically, by providing a wide range of standard and customized embedded computer products. Our products have application in diverse industries, including space and aviation, telecommunications, military and government, transportation, telemetry, robotics, networking, broadcasting, wireless communications and medical imaging.

We have grown because we understand our role in the embedded computing process: we make components which are part of larger, more complicated devices. As embedded computer applications expand, we broaden our product line to meet our customers' needs and to attract new customers. We invest in technology and customer service so that we can grow with our customers.

We have grown organically and through strategic acquisitions, acquiring companies that supplement our core competencies – a pattern we expect to continue. Our organic growth is driven by adding new products, improving existing products through our research and development program, and attracting new customers with our products and service. We also completed eleven acquisitions between 1992 and June 2004 that broadened our product offerings and our customer base.

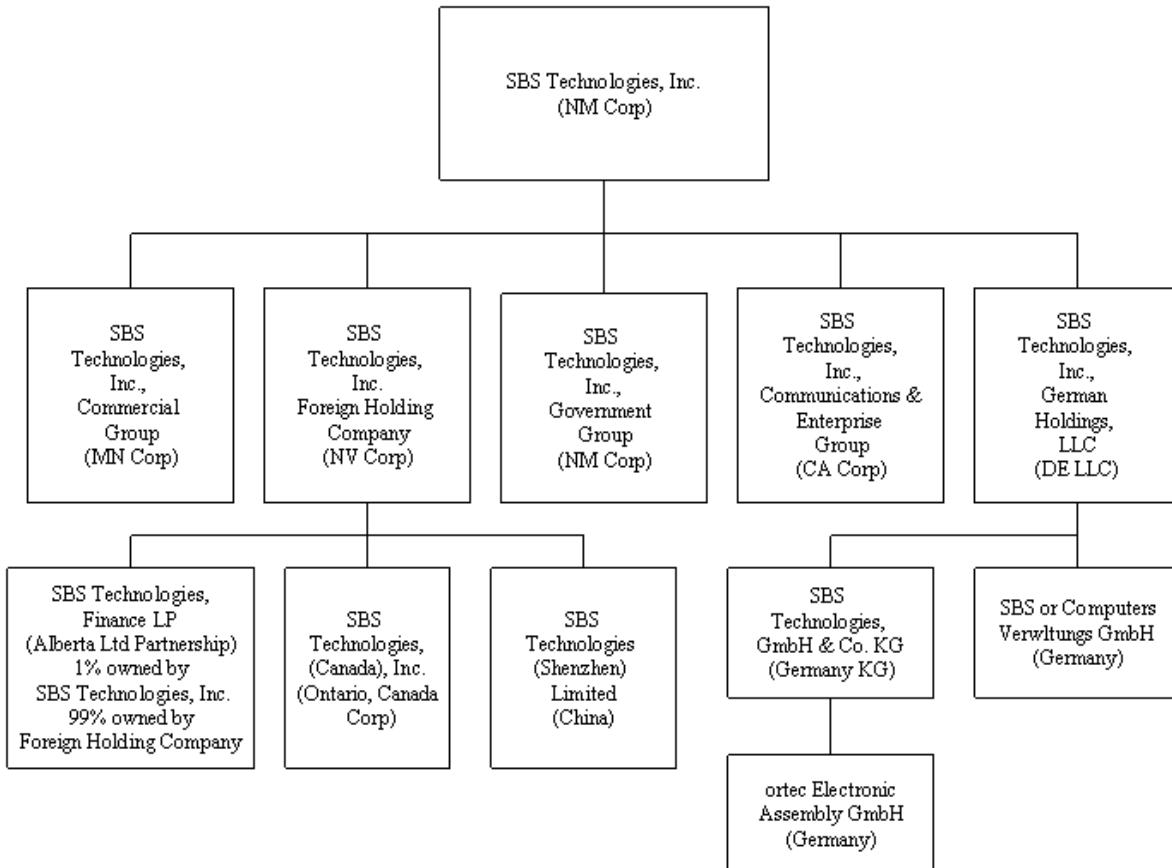
SBS Technologies, Inc. was incorporated in New Mexico in November 1986 and began operations in September 1987. Our executive office is located at 2400 Louisiana Boulevard, NE, AFC Building 5, Suite 600, Albuquerque, New Mexico, 87110, telephone number (505) 875-0600. As of June 30, 2004, SBS Technologies, Inc. had five direct subsidiaries: SBS Technologies, Inc., Commercial Group ("SBS Commercial"), SBS Technologies, Inc., Government Group ("SBS Government"), SBS Technologies, Inc., Communications and Enterprise Group ("SBS Communications"), SBS Technologies, Inc. Foreign Holding Company ("Foreign Holding"), and SBS Technologies, Inc., German Holdings, LLC ("German Holdings"). In July 2002, the Avionics Products division of SBS was combined with SBS Government. In September 2002, SBS Technologies, Inc., Industrial Computers, and SDL Communications, Inc., both of which were formerly subsidiaries of SBS Technologies, Inc., merged into SBS Technologies, Inc., Communications Products, a subsidiary of SBS Technologies, Inc., at which time its name was changed to SBS Technologies, Inc., Communications and Enterprise Group.

In April 2003, German Holdings acquired all of the shares of SBS Technologies Holding GmbH ("Holding GmbH"), formerly a subsidiary of Foreign Holding, and all of the shares of SBS or Computers Verwaltungs GmbH ("Verwaltungs"), formerly a subsidiary of Holding GmbH. Later in April 2003, Holding GmbH was merged into SBS Technologies, GmbH & Co. KG ("KG"), formerly a subsidiary of Holding GmbH. As a result of the merger, ortec Electronic Assembly GmbH ("ortec"), formerly a wholly-owned subsidiary of Holding GmbH, is a wholly-owned subsidiary of KG. KG and Verwaltungs are subsidiaries of German Holdings. KG is a partnership between German Holdings as sole limited partner and Verwaltungs as sole general partner.

SBS Technologies (Canada), Inc. ("SBS Canada") is a subsidiary of Foreign Holding. Effective June 30, 2003, SBS Canada acquired all of the shares of Avvida Holdings Corp. ("Avvida Holdings"). At that time, Avvida Systems Inc. ("Avvida Systems") was a subsidiary of Avvida Holdings. In July 2003, both Avvida Systems and Avvida Holdings were amalgamated under Canadian law into SBS Canada. SBS Technologies Finance LP, a limited partnership, is owned 99% by Foreign Holding as sole general partner, and 1% by SBS Technologies, Inc. as sole limited partner.

SBS Technologies (Shenzhen) Limited, a subsidiary of Foreign Holding, was formed in June 2004.

A chart of our corporate structure follows:



SBS Technologies®, IndustryPack®, Omnispan®, and dataBLIZZARD® are registered trademarks of SBS. PC•MIP® is a registered trademark of MEN Micro, Inc. of Carrollton, Texas, and SBS. All other trademarks or tradenames referred to in this document are the property of their respective owners.

### ***Corporate Governance***

We strive to achieve excellence and integrity in all of our business practices, including corporate governance, oversight, accountability and transparency. We believe we have incorporated best practices in our governance, including those currently required by the Sarbanes-Oxley Act of 2002 and The Nasdaq Stock Market®. The following are several examples of corporate governance initiatives implemented by the Company, many dating several years before the passage of the Sarbanes-Oxley Act:

- The Company's Board of Directors is comprised of seven members, five of whom are independent from management ("Independent Directors"). The Board has consisted of a majority of Independent Directors since 1992.
- The Board has three standing committees: the Audit Committee, the Corporate Governance and Nominating Committee, and the Management Development and Compensation Committee. Each Committee has a written charter, available for review on our web site at [www.sbs.com](http://www.sbs.com), and membership on all Board Committees is limited to the Independent Directors.
- At each regularly scheduled meeting of the Board of Directors, a meeting is held of the Independent Directors without any company officer or Employee Director participation. The Independent Directors' meeting is chaired by the Board's Lead Director, who is an Independent Director. These meetings have been conducted since 1998.
- The Company has an Internal Financial and Disclosure Controls Committee, whose primary duties are to establish, evaluate and maintain systems of internal controls regarding financial information of the Company and disclosures required by applicable laws to ensure (a) accuracy, completeness, reliability and timeliness of financial and other reports, (b) effectiveness

and efficiency of operations, and (c) compliance with applicable laws and regulations. That committee's charter is available on our web site at [www.sbs.com](http://www.sbs.com).

- The Company has disseminated to all of its employees a Financial Complaint Procedures Policy, available for review on our web site at [www.sbs.com](http://www.sbs.com), to enable the anonymous reporting of any possible financial wrongdoing within the Company.
- The Company has adopted a Code of Ethics, available for review on our web site at [www.sbs.com](http://www.sbs.com), binding upon all directors and employees of the Company, designed to deter wrongdoing and promote honest and ethical conduct, full, fair, accurate and timely public disclosures, compliance with all governmental requirements, prompt internal reporting of violations of the Code of Ethics, and accountability for adherence to the Code of Ethics. We will disclose on our website when there have been waivers of, or amendments to, the Code of Ethics.
- The Board of Directors has adopted a Statement on Corporate Governance, available for review on our website at [www.sbs.com](http://www.sbs.com), which contains corporate governance standards applicable to the Board, including Board functions, structure and operations of the Board and its Committees, and shareholder meetings.
- The reports we file with the U.S. Securities and Exchange Commission on a current, quarterly and annual basis are available, as soon as practicable after they are filed, on our website at [www.sbs.com](http://www.sbs.com).

The following narrative should be read in conjunction with the Section entitled "Risk Factors."

#### ***SBS' Operating Segments***

Throughout our fiscal year ended June 30, 2004, we operated worldwide based on geographic markets through two operating segments: the Americas Group and the Europe Group. These segments enable management to focus on regional market development, alignment of sales channels with customers' product needs, and enhancement of customer service and satisfaction. Each segment has management who report directly to our Chief Executive Officer and its own sales and distribution channels. The Americas Group consists of our operations based in the United States and Canada, and most recently Shenzhen, China. This includes the engineering, test and assembly activities in Albuquerque, New Mexico; Mansfield, Massachusetts; Newark, California; Raleigh, North Carolina; St. Paul, Minnesota; and Waterloo, Ontario, Canada, the manufacturing operations located in St. Paul, Minnesota and the sales and technical support activities located in Shenzhen, China. The Europe Group consists of our operations based in Germany, which include the engineering, test, assembly, and manufacturing activities located in Augsburg and Mindelheim, Germany. For fiscal years 2004, 2003 and 2002, sales by operating segments are listed below.

<b><u>Sales By Segment</u></b> <b>(dollars in millions)</b>						
	<b>Fiscal years ended</b>					
	<u>June 30, 2004</u>	<u>% of total</u>	<u>June 30, 2003</u>	<u>% of total</u>	<u>June 30, 2002</u>	<u>% of total</u>
Americas Group	\$ 97.1	73%	\$ 94.3	82%	\$ 106.3	89%
Europe Group	36.8	27%	21.2	18%	12.6	11%
Total	<u>\$ 133.9</u>	<u>100%</u>	<u>\$ 115.5</u>	<u>100%</u>	<u>\$ 118.9</u>	<u>100%</u>

See Notes 13 and 14 to SBS' Consolidated Financial Statements for additional information about SBS' operating segments, geographic areas, and major customers.

#### ***Order Backlog***

Order backlog expected to be filled within the fiscal year ending June 2005 was approximately \$28.0 million and \$14.2 million, as of September 1, 2004, for the Americas Group and Europe Group, respectively. Our order backlog represents customer orders that have been contracted for future delivery. Order backlog as of September 1, 2003, was approximately \$19.0 million and \$8.9 million for the Americas Group and Europe Group, respectively. We have experienced order cancellations and requests for extensions of product shipments in the past and may continue to experience these cancellations and extensions in the future. As a result, shipments of current backlog may be delayed or canceled.

### ***SBS' Products***

Both the Americas Group and the Europe Group sell our complete portfolio of embedded computer products into the government, commercial and communications end markets. Our product line is strategically focused on open standards embedded computing, and we serve most parts of the embedded market. We produce more than 450 standard products which can be combined, configured and customized in literally thousands of ways.

We offer individual components like Input/Output modules (I/O), bus adapters, carrier cards, and single board computers, plus network switches, blades and fully integrated computer systems. Many of these products are available in ruggedized versions, which can operate in conditions of extreme temperature, vibration, shock and humidity.

Within our diverse collection of product lines, we offer many different form factors, including PCI, CompactPCI®, PMC, AMC, Processor PMC, and Industry Packs. We support our products with software in multiple operating systems. Our wide selection of single board computers enables a system designer to choose between multiple processor types, speeds, form factors, memory configurations, I/O types and rugged build grades. Similarly, our Field Programmable Gate Array products (FPGAs) allow designers to create custom processors by programming the hardware to execute their particular application.

Our I/O products greatly expand the capabilities of our Single Board Computers by adding additional networking capabilities, by adding more processing power, by allowing incompatible systems to communicate, by providing network switching and monitoring capabilities, or by adding more powerful graphic processing power. Our I/O technologies include popular standards such as SCSI, iSCSI, IEEE 1394 (Firewire), Ethernet, InfiniBand®, MIL-STD-1553, Fibre Channel, HIPPI, and telecom standards such as T1/E1/J1, HSSI, T3/E3, OC-3/STM-1 including HDLC, ATM, SONET, Frame Relay, TDM and IP.

In addition to producing board-level embedded computer products, SBS produces finished computer systems. This process includes designing and building the “boxes” the computers are housed in, installing the single board computers and I/O modules, and testing and certifying the entire system.

We also deliver the software tools that are necessary to integrate our products into the overall design. This includes drivers, driver development kits, board support packages, protocol stack and specialized tools for specific markets.

### ***Customers and Applications***

Our broad range of products is used by a diversified OEM customer base serving the government, commercial and communications end markets. Our products are used in a variety of applications in diverse industries including space and aviation, telecommunications, military and government, transportation, telemetry, robotics, networking, broadcasting, wireless communications and medical imaging. In fiscal year 2004, one customer (Applied Materials) represented 10% of our total sales and in 2003 and 2002, no one customer equaled or exceeded 10% of our sales. OEMs serving the communications market use our products in applications such as wireless base station controllers, optical switches, routers and network monitoring, and security applications. OEMs serving the commercial market use our products primarily to build products that are used in semiconductor manufacturing, industrial automation, medical imaging, and entertainment applications. Examples of these applications include semiconductor manufacturing equipment, CT scan and MRI equipment, automotive manufacturing and test equipment, test and measurement equipment, industrial automation equipment, commercial aircraft flight simulators, and audio mixing and video authoring equipment. OEMs serving the government market use our products in mission critical components in fighter aircraft and ground vehicles, flight and ground simulation, electronic system test solutions, and data link and command and control applications. Examples of these applications include systems and equipment for military aircraft, military ground vehicles, navy vessels, telemetry equipment, and space exploration applications.

### ***Sales and Marketing***

We market our products both domestically and internationally utilizing a combination of direct employee sales personnel, independent manufacturers' representatives, and distributors. As of August 1, 2004, we had 92 employees, who typically hold engineering degrees, in sales, marketing and customer relations, 17 U.S.-based independent manufacturers' representatives and 35 distributors located outside the U.S. Within North America, our direct employee sales personnel are deployed regionally throughout the U.S. and Canada as sales specialists in our traditional markets. Within Europe, as of August 1, 2004, we have direct employee sales personnel located in the United Kingdom, Sweden, France, and Germany. Sales into the Asian markets are primarily through distributors supported by our employees of SBS Technologies (Shenzhen) Limited. Domestically and internationally, the direct employee sales personnel are supported by field application engineers, who provide pre-sale technical support to our customers, and business development personnel, who specialize in our traditional markets of commercial,

government and communications. We serve a diverse set of large and small customers. In order to gain access to this diverse customer base, we use all available selling channels. Domestically, the direct employee sales personnel generally sell to larger OEM accounts, while manufacturers' representatives sell to smaller accounts. Internationally, our direct employee sales personnel sell to larger OEM accounts, and independent distributors sell to smaller accounts. All quoting, pricing and final order acceptance for all sales are controlled by the responsible product line manager.

We maintain our primary sales and support offices in Albuquerque, New Mexico; Raleigh, North Carolina; Mansfield, Massachusetts; St. Paul, Minnesota; Waterloo, Ontario, Canada; Augsburg, Germany; and Shenzhen, China. Sales and sales leads are generated through a range of activities, including direct sales calls, identification of participants in key defense and government related programs, participation in numerous trade shows, direct mail catalogs, advertisements in leading trade publications, and our web site.

### ***Research and Development***

We invest in research and development programs to develop new products in related markets and to integrate state of the art technology into existing products. As of August 1, 2004, we had approximately 155 employees engaged in research and development activities. Of these employees, 82 have technical degrees and 36 have advanced degrees. We seek to combine special-purpose hardware, firmware and software in our products to provide our customers with the desired functionality. Our research and development expense was \$20.6 million, \$18.1 million, and \$18.5 million in fiscal year 2004, 2003, and 2002, respectively, corresponding to 15.4%, 15.6%, and 15.5% of sales, respectively.

We have several trademarks and have one pending application for another. However, we have generally sought only limited patent protection for our technology. Currently, we have only six U.S. patents issued and two Canadian patents issued, expiring December 2013 through October 2021. We primarily rely on trade secrets for protection of our intellectual property and believe that future financial performance is much more dependent on the timely introduction of new products and technology and our customer relationships than protection of our intellectual property.

With a product line of over 450 different products, a portion of our research and development efforts is focused on sustaining and improving the existing products. In addition, we continue to develop new standard products for all of our markets, as well as adding new technologies to our product line. For fiscal year 2004, we released thirty-seven new products to the marketplace. In our single board computer product line we introduced the CT9, CR9 and CP9 Intel® Pentium M® based compact PCI cards as well as the VR9 VME bus Pentium M card. For 3U compact PCI we introduced the CR3 and CA3 Intel Ultra Low Voltage Celeron® processor card. These cards are designed to be used for all of our markets and are available in air cooled as well as conduction cooled configurations. A new technology, FPGA centric computer platforms, was added to the single board computer family in fiscal year 2004. The first FPGA product was a PCI-based card and the second was an FPGA-based PC104 card. In addition to releasing new single board computers, we also released new versions of packaged systems. We released the ruggedized PC7 Intel Pentium III® based industrial control computer. The PC7R is dustproof and waterproof and is designed to be used in harsh environments. We also released the new advanced mission computer product that is one of the only off-the-shelf standard computers available that can be used for military flight and mission computer applications. The advanced mission computers are available in 3U and 6U cPCI, and 6U VME, and are fully qualified for military programs.

In fiscal year 2004, we expanded our I/O products by increasing our Ethernet product line with two cPCI Ethernet switches and two new gigabit Ethernet PMC cards. We also extended our conduction cooled I/O product family by adding a fibre channel PMC, a 1394 PMC card, a 12 channel 3U cPCI serial card, an 8 channel PMC serial card, an audio PMC card and six new MIL-STD-1553 cards in PMC, cPCI and PCI formats. As a provider of high performance I/O solutions, we also expanded our InfiniBand product line with a twenty-four port switch and two new host bus adapter cards, one in PCI format and the other a PMC card. We extended our SCSI product line by introducing a new Ultra SCSI PMC card and adding an iSCSI PMC card, which is an internet-connected SCSI interface. To expand our I/O products for military systems applications, we also developed and released a new line of FPGA I/O cards in cPCI and VME formats that provide analog, digital, serial and custom I/O required for military applications.

For our I/O products aligned with communications applications, we released the Maxim 921-DS PMC card that provides full duplex DS3 connectivity. In addition, we developed new variants of our Wanic T1/E1 Serial monitoring cards and Maxim 524 T1/E1 cards, extended the Maxim 520 family to support rear panel I/O, and developed several customer specific wide area network cards that will be available as standard products. A major initiative was started in fiscal year 2004 to provide Advanced Mezzanine Cards (AMC) for Advanced Telecom Computing Architecture (ATCA) carrier cards. The first AMC product is the Telum 1001 which provides OC-3 connectivity.

During fiscal year 2004, we expanded our software support of real-time Linux, UNIX and Microsoft Windows® operating systems by adding drivers and new board support packages to support our new single board computers. We also released a development environment to support developing applications for our FPGA-based products.

### ***Suppliers***

We use contract manufacturing to produce substantially all of our U.S.-built board-level products. We obtain parts from large electronics parts suppliers and printed circuit boards from printed circuit board manufacturers and provide these parts and boards as kits to contract manufacturing companies that fabricate our products. Following manufacturing, we perform test, packaging and support functions for our products. We have two manufacturing facilities, St. Paul, Minnesota and Mindelheim, Germany. We have begun complete turnkey outsourcing to contract manufacturers, although it is for a small portion of our total production. We reduce our dependence on a single contract manufacturer by using multiple contract manufacturers for many of our products.

Our German operation manufactures approximately 45% of its board-level products at its facility in Mindelheim, Germany, and uses contract manufacturers for the remainder of its manufacturing, consisting primarily of OEM production business and certain ruggedized and military applications.

### ***Competition***

The embedded computer industry is highly competitive and fragmented, and our competitors differ depending on product type, company size, geographic market and application type. Consolidation within the communications, capital equipment and defense industries has resulted in increased competition and may result in an increase in pricing pressure across our product lines. We believe we differentiate ourselves from our competition based on the following:

- broad product line,
- willingness to adapt products to customer needs (customization),
- after sale support, and
- long-term customer relationships.

Our competition in each of our product lines is described below.

Our CPU product line competes against other suppliers of CPU boards based on PowerPC® and Intel microprocessor technology, including GE Fanuc Embedded Systems, Kontron AG, Motorola, Inc., Performance Technologies, Incorporated, RadiSys Corporation, and others. In the ruggedized computer board and system market primarily serving military customers, our main competitors are Curtiss-Wright Corporation and Radstone Technologies PLC.

Our WAN I/O products compete with other suppliers of similar products within the embedded computer market. They include companies such as Interphase Corporation, Performance Technologies, Incorporated, and SBE, Inc.

Our general purpose I/O products are standards-based I/O modules for technologies such as Ethernet, Fibre Channel, and Serial. Among our competitors for these products are Acromag, Inc., Curtiss-Wright Corporation, GE Fanuc Embedded Systems, and a few small companies. Specialized products such as bus adapters and dataBLIZZARD have no direct competitors. Our InfiniBand technology products compete with Infinicon Systems, Inc., and a number of small start-up companies serving that market.

Our avionics interface products compete with those of other companies such as Ballard Technologies, Inc., Condor Engineering, Inc., Data Devices Corporation, Excalibur Technologies Corporation, and Gesellschaft Fur Angewandte Informatik und Mikroelektronik GmbH.

SBS Canada designs FPGA computing products that apply FPGA technology to processing applications often associated with DSP boards or single board computers. We compete with companies offering these technologies like Mercury Computer Systems, and imaging companies such as Matrox Graphics Inc., as well as a few small companies with FPGA products such as Annapolis Micro Systems, Inc.

Our systems and enclosure products compete with other suppliers of special purpose PC and CompactPCI platforms, enclosures and turnkey systems, such as Motorola, Inc. and RadiSys Corporation.

## ***Employees***

As of August 1, 2004, we had approximately 472 employees at our nine locations: Albuquerque, New Mexico; Newark, California; Raleigh, North Carolina; St. Paul, Minnesota; Mansfield, Massachusetts; Waterloo, Ontario, Canada; Shenzhen, China; and Augsburg and Mindelheim, Germany. Of these employees, 66 were in executive and administrative positions; 92 were in sales, marketing and customer relations; 155 were in research and development; 148 were employed in support of ongoing production, and 11 were employed on a part-time basis.

## ***Risk Factors***

*Statements in this Report about the outlook for our business and markets, such as projections of future performance, statements of management's plans and objectives, and forecasts of market trends and other matters, are forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from the results discussed in the forward-looking statements. Factors that may cause such a difference, and may impact our future financial performance, include, but are not limited to, those discussed below:*

### **Risks Related to Our Business**

***Our period to period sales and operating results have fluctuated, and may continue to fluctuate significantly, which has caused, and may continue to cause, volatility in the market price for our common stock.*** Our Company has experienced fluctuations in its period to period sales and operating results in the past, and management expects that fluctuations will occur in the future. Our sales, on both an annual and a quarterly basis, can fluctuate as a result of a variety of factors, many of which are beyond our control and which we may not be able to predict. These factors include:

- the timing and volume of customer orders and delays,
- success in achieving design wins in which our products are designed into those of our customers,
- manufacturing delays,
- delays in shipment due to component shortages,
- cancellations of orders,
- changes in the mix of products sold,
- the rate of introduction of new products,
- ability to maintain appropriate inventory levels,
- excess or obsolete inventory and changes in valuation of inventory,
- cyclicalities or downturns in the markets served by our customers, including significant reductions in defense, communications and capital equipment expenditures,
- political, legal, regulatory and economic conditions and developments in the areas of the world in which we operate or into which we might expand our operations,
- competition from new technologies and other companies,
- variations in sales channels, product costs and the mix of products sold, and
- economic disruptions due to terrorist activity or epidemics.

Because fluctuations in operating results have happened in the past, and may continue to happen in the future, we believe that comparisons of the results of our operations for preceding quarters and fiscal years are not necessarily meaningful, and that investors should not rely on the results for any one quarter or year as an indication of how the Company will perform in the future. Investors should also understand that, if our sales or earnings for any quarter or year are less than the level expected by securities analysts or the market in general, the market price for the Company's common stock has been in the past, and may be, in the future, subject to an immediate and significant decline.

***Our sales have been, and may in the future be, significantly reduced due to volatile communications and capital equipment markets.*** We derive a significant portion of our sales from products for communications and capital equipment applications. The communications and capital equipment markets are characterized by intense competition and rapid technological change. The communications market grew rapidly in the late 1990's, but experienced depressed conditions during recent years, from which a recovery appears to have begun. For example, our sales into that market dropped by over 60% between our fiscal year 2001 and fiscal year 2002 and by another 30% from fiscal year 2002 to fiscal year 2003 before staging some recovery in fiscal year 2004. The volatility of the communications market over recent years could result in a future dramatic downturn in areas of the

communications market targeted by us, such as wireless telephony and network monitoring, resulting in reductions in sales into that market.

***Our future sales may be limited if anticipated increases in U.S. defense spending do not occur, if defense spending in the U.S. and other countries is reduced or not allocated in a way that benefits us, or if U.S. military actions result in reluctance by customers outside of the U.S. to purchase our products.*** We derive a significant portion of our sales directly or indirectly from the U.S. Department of Defense (DoD). The majority of our government sales are to contractors in U.S. Government military programs for either new military systems or upgrades of existing military platforms. These sales may be affected by changes in procurement policies, budget considerations, changing defense requirements, and political developments. The influence of these factors, which are largely beyond our control, could impact our financial position or results of operations.

The President's budget for the DoD for fiscal year 2005 and beyond responds to increased needs for homeland security and combating terrorism. This is evidenced by budget increases for operation readiness and personnel needs, as well as for both procurement and research and development. This trend was reiterated in the Future Year Defense Plan (FYDP) submitted with the President's budget for fiscal year 2005. It projects sustained growth in both the procurement and research and development budgets for the DoD through fiscal year 2006, and in the case of the procurement budgetary authority, through fiscal year 2009. While there is no assurance that the increased DoD budget levels will be approved by Congress, the current U.S. defense budget outlook appears to be one of modest growth. However, the level and sustainability of growth and the amount of the budget that will ultimately be allocated to programs most closely aligned with our business, such as new military systems and upgrades of existing military platforms, is unknown, particularly in light of:

- current record U.S. government budget deficits, and
- increased expenditures on operations and maintenance arising from conflicts in Iraq, Afghanistan, and other locations, which typically do not benefit our business.

In addition, non-U.S. defense budgets have generally been declining over the past decade. This has resulted in consolidation in the European aerospace industry. This type of environment could reduce opportunities, and increase competition and pricing pressure, for sales of SBS products into non-U.S. government markets. Further, international backlash against United States government policy decisions relating to terrorism, the conflicts in Iraq and Afghanistan, and other international events may result in reluctance in certain foreign countries to buy products from companies, like SBS, headquartered in the United States.

***We must persuade customers to outsource their component needs to grow our business.*** Many of our potential customers design and manufacture embedded computer components internally, which they may view as a cost-savings over purchasing these components from suppliers like SBS. To increase our sales, we need to persuade them that use of our components and services is cost-effective.

Increased market acceptance of our products also depends on a number of other factors, including:

- the quality of our design and production expertise,
- the increasing use and complexity of embedded computer systems in new and traditional products,
- the expansion of markets that are served by embedded computers,
- time to market requirements of our products,
- the assessment by our customers of direct and indirect cost savings, and
- our customers' willingness to rely on us for mission-critical applications.

Any failure to persuade customers to outsource their embedded computer needs could reduce our future revenues and earnings.

***We face significant competition.*** The embedded computer industry is highly competitive and fragmented, and is in the process of consolidating, such as the recently announced acquisition of Force Computers, Inc. by Motorola Inc. Our competitors differ depending on product and market type, company size, geographic market and application type. We face competition in each of our product lines.

Competition in all of our product lines is based on:

- performance,

- time-to-market,
- customer support,
- product longevity,
- existing customer relationships,
- supplier stability,
- price,
- breadth of product offerings, and
- reliability.

Many of our existing and potential competitors are companies larger than we are that have a number of significant advantages over us, including:

- significantly greater financial, technological and marketing resources, giving them the ability to respond more quickly to new or changing opportunities, technologies and customer requirements,
- established relationships with customers or potential customers, which can make it harder for us to sell our products to those customers,
- a longer operating history, and
- more extensive name recognition and marketing capability.

In addition, existing or potential competitors may establish cooperative relationships with each other or with third parties, or adopt aggressive pricing policies to gain market share.

Because of increased competition, we might encounter significant pricing pressures across our product lines. These pricing pressures could result in significantly lower average selling prices and reduced profit margins for our products. We may not be able to offset the effects of any price reductions with an increase in the number of our customers, cost reductions or otherwise. We cannot assure investors that we will be able to compete effectively in our current or future markets.

***If we do not persuade OEM's to use our products instead of those of other suppliers, our sales could be harmed.*** Our sales depend, in part, on our ability to obtain and maintain design wins for our products from OEM's. OEM's that do not currently integrate our components into their products may not be willing to purchase components from us because the cost of integrating new components into their products may be more expensive than continuing to use existing components. OEM's currently using our components often re-bid for next-generation components and may elect to use another supplier's components if the other supplier's designs are superior to our designs. Also, OEM's currently integrating our components may redesign their products in a manner that no longer requires our components. If we fail to maintain existing design wins or to achieve new design wins, our sales could be reduced.

***We might have to expend substantial funds to redesign our products because of changes in industry standards, customer preferences or technology.*** Most of our products are developed to meet industry standards that define the basis of compatibility in operation and communication of a system supported by different vendors. These standards are continuing to develop. If these standards are eliminated, changed, or are superseded with more advanced technologies, the design of our products could be inappropriate or obsolete, and we could be required to undertake costly redesign and research and development efforts. Our sales also depend in part on our ability to develop state of the art products that comport with changing customer preferences. We may not be successful in developing these products in a timely manner, or in selling the products we develop. Our sales could significantly decrease, and our products could become obsolete, if we fail to adapt timely to changing industry standards, advances in technology, or customer preferences.

***We purchase many of our components from third party suppliers who may discontinue or change their products or have insufficient supply.*** Many of our products contain state-of-the-art electronic components, such as microprocessors and memory technology. We depend upon third parties for our supply of many of these components. We obtain some of these components from a sole supplier or a limited number of suppliers, for which alternate sources may be difficult to locate. We have experienced, and may experience in the future, component part shortages, and we have in the past built, and may in the future build, inventory of these components. Moreover, suppliers may discontinue or upgrade some of the products incorporated into our products, which could require us to redesign a product to incorporate newer or alternative technology. Our inventory of component parts may become obsolete, which has in the past and may in the future result in write-downs. Although we believe that we have arranged for an adequate supply of components to meet our short-term requirements, we do not routinely obtain long-term binding contracts

with our suppliers to assure future availability. If sufficient components are not available when we need them, our product shipments could be delayed, which could adversely affect our sales during certain periods as well as lead to customer dissatisfaction. If enough components are unavailable, we might have to pay premiums for parts in order to make shipment deadlines. Paying premiums for parts, building inventory of scarce parts, or having our existing inventory become obsolete could lower or eliminate our profit margin, reduce our cash flow, and otherwise harm our financial performance.

***We use contract manufacturers to produce the bulk of our board-level products and are dependent on their timeliness, quality, and availability.*** We obtain parts from large electronics parts suppliers and printed circuit boards from printed circuit board manufacturers and provide these parts and boards as kits to contract manufacturing companies that fabricate our products. Many of the contract manufacturers we utilize are small companies with limited capital resources. We reduce dependence on a particular contract manufacturer by using multiple contract manufacturers for many of our products, although there is no assurance that we will not experience delays in obtaining product from contract manufacturers. If we must move our production to new contract manufacturers due to non-performance by current contract manufacturers, additional delays in obtaining product could be incurred, as qualifying new contract manufacturers is costly and time-consuming. If we are unable to meet our customers' delivery requirements due to delays in obtaining product from contract manufacturers, our sales and results of operations could be materially reduced. We also use contract manufacturers with operations in low-cost locations, such as Asia. Those products may be subject to shipping and other delays resulting from the location of those fabrication facilities. These manufacturers are also subject to political, economic and regulatory risk similar to those arising from our international sales and operations generally, as described on page 13.

***We often incur substantial expense and development time well in advance of sales, requiring accurate gauging of future market demand.*** Our business depends upon continually introducing new and enhanced products and solutions for business needs. The development or adaptation of products and technologies requires us to commit financial resources, personnel and time significantly in advance of sales. In order to compete, our decisions with respect to those commitments must accurately anticipate both future demand and the technologies that will win market acceptance to meet that demand. In addition, our customers typically require several months to test and evaluate our products before designing their products to incorporate our components. Once our customers have decided to use our components, it may take up to 18 months or longer to begin volume production of products incorporating these components. Because of this lengthy sales cycle, we may experience delays from the time we increase our operating expenses and our investments in inventory until the time that we generate sales from these components. We may never generate sales from components after incurring development expenses if our customers decide not to purchase them. Even if our customers select our components to incorporate into their products, our customers may not be able to market or sell their products successfully.

***We are subject to order and shipment uncertainties that could harm our operating results.*** We typically sell our products pursuant to purchase orders that customers can cancel or defer delivery on short notice without incurring a significant penalty. Cancellations or deferrals could cause us to hold excess inventory that may not be salable to other customers at commercially reasonable terms, and which could reduce our profit margins, require inventory write downs, and restrict our ability to fund our operations. This risk is exacerbated by a current trend from our customers of requiring shorter lead times between placing an order with us and the shipment date. That typically necessitates an increase in our inventory of that product, raising the likelihood that upon cancellation or deferral, we may be holding greater amounts of inventory.

***We have limited patent protection covering our technology, and we may not be able to protect our intellectual property. Disputes could be expensive.*** Our success depends, in part, on our ability to develop and protect our intellectual property. We have sought only limited patent protection for our technology. We currently have six U.S. patents and two Canadian patents issued and no U.S. patents pending. We cannot guarantee that our existing patents will be enforced in a court of law if challenged. Patent applications in the United States are not publicly disclosed until the patents are issued.

We primarily rely on trade secret laws, industrial know-how and confidentiality agreements with employees, customers, distributors and vendors to protect our intellectual property and believe that future financial performance is much more dependent on the timely introduction of new products and technology and our customer relationships than protection of our intellectual property. Third parties or employees may breach those confidentiality agreements or otherwise attempt to disclose, obtain or use our products and technologies.

We enter into contracts with OEM's which typically provide for broad indemnification of the OEM's against allegations of infringements of intellectual property rights arising from our products, including costs of defense. We do not carry insurance covering any such claims. Any such claim or claims could materially harm our financial condition.

We may have to litigate to enforce or defend our intellectual property rights. Any litigation, regardless of outcome, may be costly and time consuming. Further, if it were ultimately determined that our claimed intellectual property rights are unenforceable, or that our products infringe on the rights of others, we may be required to pay past royalties or obtain licenses to use technologies. We may not be able to obtain licenses for these technologies on commercially reasonable terms, or at all.

***General business conditions are vulnerable to the effects of epidemics, which could materially disrupt our operations and financial results.*** Our Company is vulnerable to the general economic effects of epidemics and other health-related concerns. In mid-2003, the outbreak of the SARS epidemic resulted in quarantines and substantial curtailment of travel and business activities for areas as geographically diverse as China and Toronto, Ontario. During that time, the epidemic disrupted sales activities of SBS Canada with a significant customer in China. We believe that many growth opportunities for current and future SBS products are located in Asia and other parts of the world where public health systems are not considered to be as advanced as in North America and Western Europe. Further, we have significant customers, and significant end-customers of our customers, located in Asia, including China, which are areas SBS has specifically targeted for growth. A recurrence of SARS or any other epidemic could substantially reduce or delay regional or worldwide demand for our products, or disrupt supply channels, which could materially impact our future results of operations.

### Risks Related to Our Financial Condition

***Our success depends, in part, on our ability to identify, acquire and successfully integrate new businesses.*** A major element of our business strategy is to pursue acquisitions that either expand or complement our business. We have increased the scope of our operations through eleven acquisitions since 1992, including the June 2003 acquisition of Avvida Systems, now SBS Canada. Where business conditions permit, we intend to actively pursue acquisition opportunities whenever they arise. This acquisition strategy may pose additional risks to us, including:

- We might not be able to identify or acquire acceptable acquisition candidates on favorable terms, and in a timely manner.
- Our management, financial controls, internal controls over financial reporting, personnel, and other corporate support systems might not be adequate to manage the increase in the size and the diversity of scope of our operations as a result of acquisitions and to effectively integrate acquired businesses.
- Our acquisitions might not increase revenue or earnings, and the companies acquired might not continue to perform at their historical or anticipated levels.
- We may use cash for acquisitions that would otherwise be available to fund our operations or to use for other corporate purposes.
- Our shareholders may experience dilution if we use the Company's capital stock to pay for acquisitions.
- We may incur debt to pay for acquisitions, resulting in interest costs and reduced earnings.

***We may need to raise additional capital to fund our operations and to complete acquisitions.*** We depend on cash flow from operations to fund our operations and pay for our acquisitions. If we experience decreased sales, increased expenses, or a combination of the two, we may need to raise additional capital to fund our operations or acquire other businesses. If we decide to do so, we could attempt to issue debt securities or capital stock. We may not be able to sell these securities under then current market conditions. Even if we were successful in finding buyers for our securities, the buyers could demand commercially unreasonable terms. For example, if we had to sell debt securities, we might be forced to pay high interest rates or agree to onerous operating covenants, which could in turn harm our ability to operate our business by reducing our cash flow and restricting our operating activities. If we were to sell the Company's capital stock, we might be forced to sell shares at a depressed market price, which could result in dilution to our existing shareholders. In addition, any shares of capital stock we may issue may have rights, privileges, and preferences superior to those of our common shareholders. If we are unable to raise additional capital on commercially reasonable terms, we may be required to reduce our operations and delay or terminate any potential acquisition plans, which would harm our ability to grow.

***If our sales do not increase, or if they decline, we could experience difficulty in obtaining debt or equity financing.*** Contraction and declines in the markets we serve have had and may in the future have an adverse impact on our sales and income. We currently do not have any bank credit facility in place. We may require external financing in the future, and that financing may not be available on terms acceptable to management or at all. In the future, if our sales do not increase, or if they decline, it would likely impede our ability to raise funds through the sale of debt or equity securities.

***Our future results are subject to the efficiency of our past and future consolidation efforts.*** We have consolidated operations in the past, including Communications and Enterprise Group operating facilities previously based in Madison, Wisconsin, and

Carlsbad, California. These consolidations included moving manufacturing, testing and support functions to the St. Paul, Minnesota, facility, and moving certain product design functions to the Mansfield, Massachusetts and Raleigh, North Carolina facilities in fiscal years 2003 and 2004. We may elect to consolidate other operations in the future. Failure to effect a consolidation efficiently could result in missed customer deliveries, higher costs, reductions in quality, and lost productivity on other important projects, any of which could adversely affect our future results of operations.

***Our earnings have been, and could in the future be, adversely affected because of charges resulting from acquisitions, or an acquisition could reduce shareholder value.*** As part of our strategy for growth, we acquire compatible businesses. In accounting for a newly acquired business, we are, in many cases, required to amortize, over a period of years, certain identifiable intangible assets. Although the acquired business' current operating profit may offset the amortization expense, a decrease in the acquired business' operating profit could reduce our overall net income and earnings per share. Changes in future markets or technologies may require us to amortize intangible assets faster and in such a way that our overall financial condition or results of operations are harmed. If economic and/or business conditions decline in the future, we may incur impairment charges against earnings which could be significant. We may also be required, under accounting principles generally accepted in the United States of America, to charge against earnings upon consummation of an acquisition the value of an acquired business' technology that does not meet the accounting definition of "completed technology." Acquired businesses could also reduce shareholder value if they generate a net loss or require invested capital.

***We may expend resources without receiving benefit from strategic alliances with third parties.*** From time to time, we enter into strategic alliances to deliver solutions to our customers. These alliances are typically formed to provide products or services that we do not provide in our core businesses. We may expend capital and resources on these alliances but may not receive any immediate or long-term return or economic benefit from them, thereby reducing our sales and earnings.

***We depend on our employees for success.*** Our ability to maintain our competitive position and to develop and market new products depends, in part, upon our ability to retain key employees and to recruit and retain additional qualified personnel, particularly engineers. Competition for qualified employees in the computer industry is intense. In addition, we have traditionally relied in large part on granting of stock options as incentive compensation to recruit and retain qualified personnel. If proposed changes to accounting standards that require us to expense the fair value of stock option grants results in a reduction or elimination of future stock option awards to our employees, we could have difficulty recruiting and retaining qualified persons. If we are unable to retain and recruit key employees, our product development, and marketing and sales could be harmed.

***We are subject to product liability risk.*** Our products and services could subject us to product liability or government or commercial warranty claims. We maintain primary product liability insurance for our non-aviation products with a general aggregate limit of \$1.0/\$2.0 million per occurrence and a \$50.0 million excess umbrella policy. We maintain, for our aviation products, a \$100.0 million liability insurance policy, per occurrence. Our products are widely used in a variety of applications. If a claim is made against us, our insurance coverage might not be adequate to pay for our defense or to pay for any award, in which case we would have to pay for it. Also, in the future we might not be able to continue our insurance coverage at desired levels for premiums acceptable to us. If a litigant were successful against us, a lack or insufficiency of insurance coverage could significantly harm our financial condition.

***We face political, economic and regulatory risks associated with our international sales and operations not faced by businesses operating only in the United States.*** We sell our products in countries throughout the world from our United States, Canadian and German based operations. We intend to continue to expand our operations and sales outside the United States and have specifically targeted Asia, in addition to Europe, for future growth. Consistent with that policy, we opened our sales support and customer support office in Shenzhen, China in June 2004. Our international operations and sales subject the Company to risks not experienced by companies operating only in the United States, including:

- increased governmental regulations,
- export and import controls,
- political, economic and other uncertainties, including, risk of war, revolution, terrorist attacks, epidemics, expropriation, renegotiation or modification of existing contracts, standards and tariffs, and taxation policies,
- international monetary fluctuations that may make payment more expensive for foreign customers who may, as a result, limit or reduce purchases,
- exposure to different and inconsistent legal standards, particularly with respect to intellectual property,
- longer accounts receivable collection cycles,
- trade disputes or new trading policies that could limit, reduce, disrupt or eliminate our sales and business prospects outside the

- United States, and
- unexpected changes in regulatory requirements that impose multiple conflicting tax laws and regulations.
- Those risks could reduce our sales and earnings in the future.

**Exchange rate fluctuations could reduce our earnings when stated in U.S. Dollars.** Substantially all of our U.S. export sales transactions to date have been denominated in United States dollars and substantially all sales transactions of our Germany operation have been denominated in Euros. Due to the transfer of all sales and support of European customers to our European operation and the recent growth in sales experienced by our European operation, a growing percentage of our overall sales transactions has been denominated in Euros. Some sales in the future may be denominated in other currencies, including the Canadian dollar. Any decline in the value of other currencies in which we make sales against the United States dollar, the Canadian dollar or the Euro, or any decline in the value of the Canadian dollar or the Euro against the United States dollar, will have the effect of decreasing our consolidated earnings when stated in United States dollars. In the future, we may engage in hedging transactions to minimize the effect of the risks associated with these types of currency fluctuations; however, such hedging transactions could adversely impact our financial position and results of operations.

## Risks Related to Our Securities

**Our common stock price can be volatile because of several factors, including a limited public float.** During the twelve-month period ended June 30, 2004, the sales price of our common stock fluctuated between \$9.17 and \$19.46 per share. We believe that the Company's common stock is subject to wide price fluctuations because of several factors, including:

- quarterly and annual fluctuations in our operating results,
- a relatively thin trading market for our common stock, which causes trades of small blocks of stock to have a significant impact on the Company's stock price,
- announcements of new technologies by us, our competitors or customers,
- general conditions in the markets we serve,
- fluctuations in earnings of our competitors,
- changes in earnings estimates or investment recommendations by securities analysts,
- general volatility of the stock markets and the market prices of other publicly traded companies,
- economic disruptions due to terrorist activity,
- investor sentiment regarding equity markets generally, including public perception of corporate ethics and governance and the accuracy and transparency of financial reporting, and
- investor sentiment regarding the valuation of technology companies generally.

A lower stock value for SBS could make it more difficult to raise, or preclude us from raising, capital through sales of stock or other securities or obtaining debt financing.

## Item 2. Properties

We lease office and manufacturing space in Albuquerque, New Mexico, Newark, California, Raleigh, North Carolina, St. Paul, Minnesota, Mansfield, Massachusetts, Waterloo, Ontario, Canada, Augsburg and Mindelheim, Germany and Shenzhen, China. We are also obligated under a lease for our former facility in Carlsbad, California, which we vacated in August 2003 and have subleased to a third party throughout the remaining term of the lease. Our standard practice is to obtain all of our facilities through operating leases. We maintain an insurance plan covering all our facilities and contents.

The Albuquerque, New Mexico leased facility consists of approximately 42,500 square feet located in a multi-floor office building. This facility houses certain sales, engineering and support functions for SBS Government, a part of the Americas Group segment. The Albuquerque facility also serves as our corporate headquarters. The lease term runs through June 30, 2005. We believe that this facility will be sufficient to serve our needs through June 2005. Effective July 2004, we executed a lease for a one-story build-to-suit facility consisting of approximately 47,500 square feet. The term of the lease, which commences upon the later of substantial completion of construction or May 1, 2005, will run for a period of approximately 122 months expiring June 2015. We contemplate moving our entire Albuquerque operations to the new facility before the June 30, 2005 expiration of our current Albuquerque lease. The new lease contains a right of first refusal to purchase the facility, a right of early termination exercisable on or after July 1, 2012, a right to expand the premises by 10,000 square feet on or before July 1, 2010, a right to contract within the premises by 10,000 square feet on or after July 1, 2010, and a right to extend the term for up to three additional

five-year terms. We believe that the new facility will be sufficient to serve our needs through the term of the lease.

Our general purpose I/O engineering team is located in Newark, California. The facility, which contains approximately 13,000 square feet and is leased for a term expiring November 30, 2007, is a one-story, multi-tenant building in a business park. We believe that this facility will be sufficient to serve our needs through the term of the lease.

Our Intel and PowerPC CPU sales and engineering functions are located in Raleigh, North Carolina, where we lease approximately 11,700 square feet of a one-story multi-tenant facility. The lease expires January 31, 2008, subject to one option to extend the term of the lease for three additional years. We believe that this facility will be sufficient to serve our needs through the term of the lease.

Our St. Paul, Minnesota facility consists of approximately 43,650 square feet, located in a business park. This facility consists of approximately 18,850 square feet of office space occupied by certain sales, engineering, and support functions for SBS Commercial, a part of the Americas Group segment, and 24,800 square feet of manufacturing and warehouse space utilized by our U.S. manufacturing center. The lease expires on January 31, 2006. We believe that this facility will be sufficient to serve our needs through the term of the lease.

Our facility, located in Mansfield, Massachusetts is a one-story multi-tenant building in a business park. The facility consists of approximately 31,200 square feet occupied by sales, engineering and support functions for SBS Communications, a part of the Americas Group segment. The lease is for a five-year term expiring on June 14, 2005. We believe that this facility will be sufficient to serve our needs through the term of the lease.

We lease in Waterloo, Ontario, Canada, approximately 19,400 square feet of a two-story multi-tenant building located within a business park. This location includes office space, and engineering, assembly and test facilities for the operations of SBS Canada, a part of the Americas Group segment. The lease term expires November 30, 2006, subject to one option to extend the term of the lease for five additional years. We also have a right of first refusal to expand into any adjacent unoccupied portions of the building during the term of the lease. We believe that this facility will be sufficient to serve our needs through the term of the lease.

We lease in Augsburg, Germany, a six-floor building, consisting of approximately 30,000 square feet of office, test, packaging and support areas for the operations of KG, a part of the Europe Group. The lease has a term of ten years expiring December 31, 2005. We are currently negotiating an extension of the lease to January 31, 2011 to include an addition consisting of approximately 7,500 square feet, bringing the total area to approximately 37,500 square feet. We believe that the facility, as expanded, will be sufficient to serve our needs through the term of the lease.

We lease in Mindelheim, Germany approximately 6,200 square feet of a single-story multi-tenant building located within a business area, consisting of approximately 1,200 square feet of office space and approximately 5,000 square feet of manufacturing and warehouse space for the operations of ortec, a part of the Europe Group. The lease term expires August 31, 2008, subject to one option to extend the term of the lease for five additional years. We believe this facility will be sufficient to serve our needs through the term of the lease.

We lease in Shenzhen, China approximately 4,400 square feet of office space in a multi-story multi-tenancy building located within a high technology business area that houses certain sales and technical support personnel for the Americas Group. The lease term expires May 9, 2006, subject to three options to extend the term of the lease for two additional years each. We believe this facility will be sufficient to serve our needs through the term of the lease.

In August 2003, we vacated our facility located in a business park in Carlsbad, California and subsequently subleased the building to an unrelated third party. This facility consists of approximately 75,200 square feet; 32,000 square feet of office space and 43,200 square feet of warehouse space, and the lease term for both our lease and the sublease expires in April 2006.

### **Item 3. Legal Proceedings**

We are subject to various claims that arise in the ordinary course of our business. In our opinion, the amount of ultimate liability with respect to these actions will not materially affect our financial position, results of operations, or liquidity. We are not a party to, and none of our property is subject to, any material pending legal proceedings. We know of no material proceedings contemplated by governmental authorities.

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market price per share**

The Company's common stock is traded on the NASDAQ Stock Market using the symbol SBSE. Quarterly market prices (as reported on the NASDAQ Stock Market) for the last two fiscal years were:

<b><u>Fiscal Quarters</u></b>	<b>2004</b>		<b>2003</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
First	\$ 13.93	\$ 9.17	\$ 12.30	\$ 5.00
Second	17.00	9.89	12.00	6.25
Third	17.75	14.30	9.90	7.06
Fourth	19.46	12.72	9.94	6.51

**Record Holders**

Based on data provided by SBS' transfer agent and The Depository Trust Company, management believes that as of August 25, 2004, the number of share owner accounts of record, as defined by Rule 12g5-1 of the Exchange Act, was approximately 215, at which date the closing market price of SBS' common stock was \$11.15 per share.

**Dividends**

SBS has not paid any cash dividends on its Common Stock. Management's current policy is to retain earnings, if any, for use in SBS' operations and for expansion of the business. No dividend payments are anticipated in the foreseeable future (see "Management's Discussion and Analysis: Liquidity and Financial Condition").

**Unregistered Securities**

On June 30, 2003, we issued an aggregate of 386,940 shares of our common stock in connection with the acquisition of 100 percent of the outstanding common stock of Avvida Holdings Corp. and its wholly-owned subsidiary, Avvida Systems Inc. The offer and sale of these securities were affected without registration in reliance on the exemption afforded by Regulation S of the Securities Act of 1933, as amended. We filed a registration statement on Form S-3 to register the 386,940 shares issued on June 30, 2003, which was declared effective by the Securities and Exchange Commission on January 14, 2004.

**Equity Compensation Plan Information**

The following sets forth certain information as of June 30, 2004 with respect to equity compensation plans of SBS under which securities may be issued:

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, rights, restricted stock, and other stock-based awards</b>	<b>Weighted-average exercise price of outstanding options, rights, restricted stock, and other stock-based awards</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)</b>
Equity compensation plans approved by security holders	2,952,505	\$14.91	2,794,638 *
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>2,952,505</b>	<b>\$14.91</b>	<b>2,794,638 *</b>

- \* Certain equity compensation plans of the Company contain a formula that automatically increases the number of securities available for issuance by a percentage of the number of outstanding securities of the Company as follows:
  - the 1993 Director and Officer Stock Option Plan provides securities available for grant equal to 5% of the number of shares of the Company's common stock outstanding the first day of each fiscal year plus shares underlying expired or terminated options (1,405,824 shares available at June 30, 2004).
  - the 2000 Long-Term Equity Incentive Plan provides securities available for grant equal to ten percent of the adjusted average of the outstanding stock, as that number is determined by SBS to calculate net income per common share – assuming dilution for the preceding fiscal year, reduced by any shares of stock under the plan subject to unexercised options and any shares of stock under the plan subject to restrictions (452,921 shares available at June 30, 2004).

### **Issuer Purchases of Equity Securities**

Not applicable.

### **Item 6. Selected Financial Data**

The following selected financial data for the years ended June 30, 2000 through June 30, 2004 have been derived from the audited consolidated financial statements of SBS. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the audited consolidated financial statements and related notes to the consolidated financial statements included elsewhere in this report.

	<u>Years ended June 30,</u>				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
(Thousands except per share data)					
<b>Statements of Operations Data:</b>					
Sales	\$ 133,874	\$ 115,521	\$ 118,856	\$ 187,180	\$ 128,189
Gross profit	64,729	57,519	42,628	88,565	67,015
Operating income (loss)	7,132	2,165	(38,412)	27,736	15,736
Net income (loss)	5,193	(4,450) (a)	(24,360)	17,184	8,903
Per Share Data:					
Net income (loss) per common share:					
Income (loss) before cumulative effect of change in accounting principle	\$ 0.34	\$ 0.11 (a)	\$ (1.67)	\$ 1.23	\$ 0.71
Net income (loss)	\$ 0.34	\$ (0.30)	\$ (1.67)	\$ 1.23	\$ 0.71
Net income (loss) per common share – assuming dilution:					
Income (loss) before cumulative effect of change in accounting principle	\$ 0.34	\$ 0.11 (a)	\$ (1.67)	\$ 1.14	\$ 0.66
Net income (loss)	\$ 0.34	\$ (0.30)	\$ (1.67)	\$ 1.14	\$ 0.66
<b>Balance Sheet Data:</b>					
Working capital	\$ 86,715	\$ 73,187	\$ 69,304	\$ 75,282	\$ 37,535
Total assets	145,136	128,610	125,648	147,172	133,160
Total liabilities	15,509	12,503	12,002	13,377	34,146
Total stockholders' equity	129,627	116,107	113,646	133,795	99,014

Notes: We have not declared any dividends during the periods presented and we do not expect to pay dividends in the foreseeable future.

(a) The fiscal year 2003 summary financial data includes a transitional impairment charge of \$6,058,000 (or (\$0.41) per common share), net of tax, reported as a cumulative effect of change in accounting principle as a result of the Company's adoption of Statement of Financial Accounting Standards No. 142 (SFAS 142), "Goodwill and Other Intangible Assets," on July 1, 2002.

On August 18, 2000, SBS declared a two-for-one stock split for stockholders of record on September 5, 2000, distributed on September 20, 2000. All references to net income per common share, net income per common share – assuming dilution, common stock, and stockholders' equity have been restated as if the stock split had occurred as of the earliest period presented.

On June 30, 2003, SBS completed the purchase of Avvida Holdings and Avvida Systems (subsequently amalgamated under Canadian law into SBS Canada).

On April 12, 2000, SBS completed the purchase of SDL Communications, Inc. (subsequently merged into SBS Communications). In connection with the acquisition, SBS recorded a \$4.0 million acquired in-process research and development ("IPR&D") charge in the fourth quarter of fiscal 2000.

On December 20, 1999, SBS completed a pooling of interests transaction with SciTech Inc. ("SciTech"). SciTech was subsequently merged into SBS Communications. SciTech's historical results did not have a material effect on combined financial position or results of operations; therefore, the financial position and results of operations of SBS and SciTech are combined from October 1, 1999 on a prospective basis.

## ***Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations***

### ***Company Overview***

We design and build open-architecture embedded computer products that enable OEMs to serve the government, commercial, and communications end markets. Embedded computer products are put inside or made part of larger systems to process information, control machines, move computer data between machines, and interact with people. The companies that use our products manufacture very sophisticated, expensive devices, for example, MRI machines, flight simulators, wireless networks, fighter jets and industrial robots.

The SBS product line is strategically focused on embedded computing, and we serve virtually all parts of the market. We currently list more than 450 products in the product section of our website, [www.sbs.com](http://www.sbs.com). We offer components like I/O modules, bus adapters, carrier cards, system enclosures, FPGA boards and single board computers, as well as network switches, blades and fully integrated systems. Many of these products are available in ruggedized versions, which can operate in conditions of extreme temperature, vibration, shock and humidity.

We serve a broad range of customers. We help our customers get to market faster, more reliably and more economically, by providing a wide range of standard and customized embedded computer products. Our products have application in diverse industries, including space and aviation, telecommunications, military and government, transportation, telemetry, robotics, networking, broadcasting, wireless communications and medical imaging.

We have grown because we understand our role in the embedded computing process: we make components which are part of larger, more complicated devices. As embedded computer applications expand, we broaden our product line to meet our customers' needs and to attract new customers. We invest in technology and customer service so that we can grow with our customers.

We have grown organically and through strategic acquisitions, acquiring companies that supplement our core competencies – a pattern we expect to continue. Our organic growth is driven by adding new products, improving existing products through our research and development program, and attracting new customers with our products and service. We also completed eleven acquisitions between 1992 and June 2004 that broadened our product offerings and our customer base.

### ***Executive Summary***

During the fiscal year ended June 30, 2004, we made significant progress in the implementation of our strategic plan. As a team, we completed a major restructure of the Company and developed an outward looking, aggressive approach to the market. As an example, we expanded into China with the opening and staffing of a sales and technical support office in June 2004.

For the past two years, we have maintained an annual book-to-bill ratio of greater than one-to-one. Throughout fiscal 2004, our customers required shorter lead times for our products, increasing our turn business and resulting in more extensive variability of our bookings. In addition, we believe the number and quality of design win opportunities in all of our markets are strong, and we remain committed to providing an excellent base of products.

During the fiscal year ended June 30, 2004 (fiscal 2004), we noted the following:

- Our book-to-bill ratio for fiscal 2004 was 1.04 to 1.

*Book-to-bill ratio represents the net value of customer orders received and booked each period divided by total sales.*

- Order backlog was \$42.1 million as of June 30, 2004, compared to \$36.2 million as of June 30, 2003;

*Order backlog represents customer orders that have been contracted for future delivery. Accordingly, these orders have not yet been recognized as revenue, but represent potential future revenue.*

- Thirty-four design wins were achieved during fiscal 2004.

*Each reported design win represents an initial purchase order of a minimum of \$100,000 and is forecasted to produce a minimum of \$500,000 in sales annually when in production.*

By end market, the design wins included twenty in the government market, seven in the commercial market, and seven in the communications market.

- During fiscal 2004, one commercial customer represented approximately 10% of our total sales and one communications customer represented approximately 8% of our total sales. We had no other customer whose sales represented more than 5% of our total in fiscal 2004.

## Financial Highlights

Select financial highlights during the year ended June 30, 2004 compared to the years ended June 30, 2003 and 2002 follows:

Thousands (except per share amounts)	Fiscal Years Ended				
	June 30,		% change	June 30,	
	2004	2003		2002	% change
Sales.....	\$ 133,874	115,521	15.9%	\$ 118,856	12.6%
Operating income (loss).....	\$ 7,132	2,165	229.4%	\$ (38,412)	118.6%
Income (loss) before cumulative effect of change in accounting.....	\$ 5,193	1,608	222.9%	\$ (24,360)	121.3%
Net income (loss)(*).....	\$ 5,193	(4,450)	216.7%	\$ (24,360)	121.3%
Income (loss) per share before cumulative effect of change in accounting.....	\$ 0.34	0.11	209.1%	\$ (1.67)	120.4%
Net income (loss) per share - assuming dilution (**). . . . .	\$ 0.34	(0.30)	213.3%	\$ (1.67)	120.4%

Sales for fiscal 2004 were \$133.9 million, a 15.9% increase from sales of \$115.5 million for the prior year.

Operating income for fiscal 2004 increased approximately \$5.0 million, or 229.4% from the fiscal 2003 balance.

Net income for fiscal 2004 was \$5.2 million, compared with income before the cumulative effect of change in accounting for goodwill of \$2.4 million and net loss of \$(4.4) million for the prior fiscal year.

\* Included in the determination of net loss in fiscal year 2003 is a transitional goodwill impairment charge of \$6.1 million (or (\$0.41) per common share), net of tax, which is reported as a cumulative effect of change in accounting principle, as a result of our adoption of SFAS 142 effective on July 1, 2002.

Net income per share – assuming dilution for fiscal 2004 was \$0.34, compared with income per common share – assuming dilution before the cumulative effect of change in accounting for goodwill of \$0.11 and net loss per common share – assuming dilution of \$(0.30) for the prior fiscal year.

\*\* Included in the results for fiscal 2004 are employee severance and consolidation costs associated with the closure of the Carlsbad, California facility of approximately \$2.4 million, which negatively impacted net income per common share – assuming dilution by \$(0.11) on an after tax basis. This compares to employee severance and consolidation costs associated with closure of the Carlsbad facility and other management actions totaling approximately \$1.7 million for fiscal 2003, which negatively impacted income per common share – assuming dilution before the cumulative effect of change in accounting for goodwill by \$(0.08) on an after tax basis.

For a more complete analysis of the financial results, see “Results of Operations” below.

#### ***Critical Accounting Policies and Estimates***

The preparation of consolidated financial statements and related disclosures in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We use estimates when we account for items such as inventory, allowances for uncollectible accounts receivable, depreciation and amortization periods for property and equipment and certain identifiable intangible assets, goodwill and intangible asset impairment analysis, and income taxes (see Note 1 to the SBS’ consolidated financial statements). These estimates and assumptions are based upon our continuous evaluation of historical results and anticipated future events. Actual results could differ from these estimates under different assumptions or conditions.

The Securities and Exchange Commission defines critical accounting policies as those that are, in management’s view, most important to the portrayal of SBS’ financial condition and results of operations and those that require significant judgments and estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in preparing our consolidated financial statements:

- *Revenue Recognition.* We recognize revenue from product sales upon shipment to customers, provided we have received a valid purchase order, the price is fixed, title has transferred, collection of the associated receivable is reasonably assured, and there are no remaining significant obligations. Where customer acceptance provisions exist, we defer revenue recognition until acceptance by the customer unless we demonstrate the product meets the customer specified criteria upon shipment provided all other revenue recognition criteria were met.
- *Inventory Valuation.* We record inventory write-downs based on estimates of obsolete or unmarketable inventory, taking into account historical usage, forecasted future demand, and general market conditions. Write-downs may also be recorded based on our decision to discontinue the marketing of certain products or product lines. If our forecasts are incorrect, market conditions deteriorate, or we decide to exit other product lines, further inventory write-downs may be required which result in an increase to cost of sales and reduced gross profit. If market conditions or demand are better than expected, we may sell inventories that have been previously written down, resulting in reduced or zero cost of sales and improved gross profit.
- *Allowance for Uncollectible Accounts.* We maintain allowances for uncollectible accounts receivable resulting from the failure of our customers to make required payments. Our estimate is based on, among other things, the aging of accounts receivable, historical write-off experience, and the current and projected financial condition of our customers. If we misinterpret the financial condition of our customers or if the financial condition of customers deteriorates, additional allowances for uncollectible accounts may be required, which would increase operating costs and reduce operating profit.
- *Goodwill.* In conjunction with the implementation of SFAS 142 as of the beginning of fiscal year 2003, we no longer amortize goodwill, but instead test for impairment at least annually. The first step of the goodwill impairment test is a comparison of the fair value of a reporting unit to its carrying value. The fair value of a reporting unit is the amount which the unit as a whole could be bought or sold in a current transaction between willing parties. The goodwill impairment test requires us to identify our reporting units and obtain estimates of the fair values of those units as of the testing date. We estimate the fair values of our reporting units using discounted cash flow and public company market multiple valuation models. Those models require estimates of future revenues, profits, capital expenditures and working capital for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans and industry data. A decline in the fair value of any of our reporting units below its carrying value is an indicator that the underlying goodwill of the unit is potentially impaired. If that occurs, we are required to complete the second step of the goodwill impairment test to determine whether the unit’s goodwill is

impaired. The second step of the goodwill impairment test is a comparison of the implied fair value of a reporting unit's goodwill to its carrying value. An impairment loss is required for the amount which the carrying value of a reporting unit's goodwill exceeds its implied fair value. If an impairment loss is recognized, the implied fair value of the reporting unit's goodwill becomes the new cost basis of the unit's goodwill.

We conduct our annual goodwill impairment test as of April 1 of each fiscal year when our budgets and operating plans for the forthcoming year are finalized. The timing and frequency of our goodwill impairment tests are based on an ongoing assessment of events and circumstances that would more than likely reduce the fair value of a reporting unit below its carrying value. We will continue to monitor our goodwill balance for impairment and conduct formal tests when impairment indicators are present.

- *Long-Lived and Intangible Assets.* We evaluate the carrying value of long-lived and intangible assets whenever certain events or changes in circumstances indicate that the carrying amount may not be recoverable. These events or circumstances include, but are not limited to, a prolonged industry or economic downturn, a significant decline in SBS' market value, or significant reductions in projected future cash flows. An asset is considered to be impaired if future undiscounted cash flows, without consideration of interest, are insufficient to recover the carrying amount of the asset. Once an asset is deemed impaired, a charge to expense is recognized to the extent that the carrying amount of the asset exceeds fair value. Fair value is generally determined by calculating the discounted future cash flows using a discount rate based upon our weighted average cost of capital. Estimates of future cash flows require significant judgment, and any change in these estimates may result in additional impairment charges and reduced operating profits.
- *Income Taxes.* Our estimate of current and deferred income taxes reflects our assessment of current and future taxes to be paid or received on items reflected in the financial statements, giving consideration to the recoverability of certain of the deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. Estimates of current income taxes include benefits for items such as general business and other credits, U.S. sales to foreign jurisdictions, and utilization of foreign tax credits. Actual income taxes may vary from our estimates due to future changes in tax laws or because of a review of our tax returns by taxing authorities, which may result in an increase or decrease to income tax expense. We must also assess the likelihood that we will be able to recover our deferred tax assets. If recovery is determined not to be more likely than not, we must increase our provision for taxes by recording a reserve, in the form of a valuation allowance, for the deferred tax assets that we estimate will not ultimately be recoverable. As of June 30, 2004, excluding certain operating losses and tax credits for U.S. State income purposes, we believe our recorded deferred tax assets will ultimately be recovered. However, should there be a change in our ability to recover the deferred tax assets, our tax provision would increase in the period we determine that recovery is no longer more likely than not.

### ***Recent Acquisitions***

We made no acquisitions during the fiscal year ended June 30, 2004. SBS completed the acquisitions described below during the fiscal year ended June 30, 2003. The acquisition was accounted for using the purchase method of accounting, and the results of operations of the acquired companies have been combined with SBS' since the date of the acquisition. The purchase price has been allocated to the underlying assets acquired and liabilities assumed based on their estimated fair values with goodwill, if any, representing the excess of the purchase price over the fair value of the net assets acquired.

On June 30, 2003, SBS acquired 100 percent of the outstanding common stock of Avvida Holdings Corp. and its wholly-owned subsidiary, Avvida Systems Inc. (Avvida), located in Waterloo, Canada. Avvida provides image processing solutions to customers serving a wide variety of applications. Avvida's focus is emerging programmable logic, including fully programmable gateway array (FPGA) technology utilized in high performance video, image and data processing solutions. We plan to incorporate FPGA technology into existing and future products across all SBS product lines.

The aggregate purchase price of \$6.2 million, including acquisition costs of \$0.6 million, was paid in cash and shares of SBS common stock valued at \$3,574,020. The value of the 386,940 shares of SBS common stock was determined based on the average market price of SBS' common shares over the two-day period before and after the terms of the acquisition were agreed to and announced. In conjunction with the purchase price allocation, the estimated fair value of identifiable intangible assets, specifically a core technology asset valued at \$970,000 and a covenant not-to-compete valued at \$1.2 million, was based on an assessment of their fair value determined by management, and goodwill of approximately \$3.5 million was recorded which is not deductible for tax purposes. During the year ended June 30, 2004, we received an income tax refund that exceeded the amount recorded at acquisition by \$104,000 which was recorded as a reduction to goodwill. The identifiable intangible assets will be amortized over a period of 5 years based on the estimated economic useful life of the core technology asset and the contractual period of the covenant.

## Results of Operations

The following table sets forth for the periods indicated certain operating data, including balances, as a percentage of sales:

Dollars in thousands	Years ended June 30,					
	2004	%	2003	%	2002	%
Sales.....	\$ 133,874	100.0 %	\$ 115,521	100.0 %	\$ 118,856	100.0 %
Cost of sales.....	69,145	51.6 %	58,002	50.2 %	76,228	64.1 %
Gross profit.....	64,729	48.4 %	57,519	49.8 %	42,628	35.9 %
Selling, general and administrative expense.....	32,504	24.3 %	33,608	29.1 %	38,817	32.7 %
Research and development expense.....	20,552	15.4 %	18,077	15.6 %	18,461	15.5 %
Employee severance and consolidation costs.....	2,400	1.8 %	1,729	1.5 %	3,232	2.7 %
Impairment of intangible assets.....	--	-- %	--	-- %	13,005	10.9 %
Amortization of goodwill .....	--	-- %	--	-- %	4,523	3.8 %
Amortization of intangible assets.....	2,141	1.6 %	1,940	1.7 %	3,002	2.6 %
Operating income (loss) .....	7,132	5.3 %	2,165	1.9 %	(38,412)	(32.3) %
Interest and other income, net.....	634	0.5 %	434	0.4 %	631	0.5 %
Foreign exchange losses.....	(348)	(0.3) %	(207)	(0.2) %	(29)	(0.0) %
	286	0.2 %	227	0.2 %	602	0.5 %
Income (loss) before income taxes and cumulative effect of change in accounting principle.....	7,418	5.5 %	2,392	2.1 %	(37,810)	(31.8) %
Income tax expense.....	2,225	1.6 %	784	0.7 %	(13,450)	(11.3) %
Income (loss) before cumulative effect of change in accounting principle.....	5,193	3.9 %	1,608	1.4 %	(24,360)	(20.5) %
Cumulative effect of change in accounting principle (net of income taxes of \$3,412).....	--	-- %	(6,058)	(5.2) %	--	-- %
Net income (loss).....	\$ 5,193	3.9 %	\$ (4,450)	(3.9) %	\$ (24,360)	(20.5) %

### Year Ended June 30, 2004 Compared to Year Ended June 30, 2003

(References to fiscal 2004 and fiscal 2003 relate to the fiscal years ended on June 30)

#### SALES

Our total sales during the fiscal year ended June 30, 2004 compared to the year ended June 30, 2003 and 2002 follows:

Thousands	Fiscal Years Ended				
	June 30,		% change	June 30, 2002	
	2004	2003			
Sales.....	\$ 133,874	115,521	15.9%	\$ 118,856	12.6%

For fiscal 2004, sales increased \$18.3 million compared to fiscal 2003, of which approximately \$2.7 million was the result of the impact of a weakening U.S. dollar on the translation of our Europe Group financial statements. Sales for the fiscal year ended June 30, 2004 include approximately \$1.1 million contributed from the acquisition of SBS Canada (formerly Avvida Systems) in June 2003. Sales by end market for fiscal 2004 compare to fiscal 2003 and 2002 as indicated below:

	<u>SALES BY END MARKET</u> <u>(dollars in thousands)</u>					
	June 30, 2004	% of total	June 30, 2003	% of total	June 30, 2002	% of total
<b><u>Fiscal year ended:</u></b>						
Government.....	\$ 67,944	51%	\$ 60,465	52%	\$ 50,425	42%
Commercial.....	39,924	30%	37,689	33%	39,625	34%
Communications.....	26,006	19%	17,367	15%	28,806	24%
Total.....	<u>\$ 133,874</u>	<u>100%</u>	<u>\$ 115,521</u>	<u>100%</u>	<u>\$ 118,856</u>	<u>100%</u>

For the year ended June 30, 2004, sales to government customers increased 12.4%, sales to commercial customers increased 5.9% and sales to communications customers increased 49.7%, all compared with the prior fiscal year. To align with current management responsibility, sales to a majority of our enterprise customers are reflected as sales to commercial customers. During fiscal 2004, one commercial customer (Applied Materials) represented approximately 10% of our total sales and one communications customer (Ericsson) represented approximately 8% of our total sales. We had no other customer whose sales represented more than 5% of our total sales in fiscal 2004, 2003 or 2002.

As we progress through calendar 2004 and start fiscal year 2005, we believe the government market will remain strong. We experienced growth in this market in fiscal year 2004, and, as planned, the majority of design wins and new opportunities were for system level solutions. The military budget is still heavily focused on unmanned vehicles and upgrade programs. Both of these are areas where SBS is positioned to win new business. Sales to communications customers increased in fiscal year 2004, and we expect additional growth in fiscal year 2005. Our traditional markets of wireless and network monitoring continue to show positive growth, and, with the addition of Advanced Telecom Computing Architecture based products we are expanding into new opportunities. In the commercial market, sales increased in fiscal year 2004 and in fiscal year 2005, we expect steady demand from semiconductor and medical equipment manufacturers, and we are optimistic that we will see growth in the industrial automation market.

Looking forward, based on our forecasts, backlog, and timing of new orders, we expect sales for the first quarter ending September 30, 2004 to be between \$36 million and \$37 million, a 35% to 39% increase compared to the first quarter of fiscal 2004; however, actual results may vary. We anticipate growth in sales throughout the remainder of fiscal year 2005 resulting in total fiscal year 2005 sales of between \$150 million and \$160 million, all from organic growth; however, actual results may vary. The assumptions on which we've based our sales projections include continued health of the markets we serve, the expectation of several government system design wins to start production, and sales to Applied Materials and Ericsson to continue at the same dollar sales level as in fiscal year 2004, approximately \$13.2 million and \$10.3 million, respectively. Based on forecasts from these two customers, and continued health of the markets we serve as evidenced by our strong quoting activity and design win funnel, we believe these assumptions are valid for the fiscal year ending June 30, 2005.

## GROSS PROFIT

Gross profit during fiscal 2004 compared to fiscal 2003 follows:

Thousands	Fiscal years ended		
	June 30,		Increase/ (decrease)
	2004	2003	
Gross profit.....	\$ 64,729	\$ 57,519	\$ 7,210
Gross profit as a percent of sales.....	<u>48.4%</u>	<u>49.8%</u>	

Gross profit as a percent of sales for the year ended June 30, 2004, decreased from levels noted in fiscal 2003 principally as a result of a higher proportion of sales of lower margin products in relation to total sales. The decrease was due to the impact of sales relating to several large, lower margin communications and commercial production orders. The Company's policy is to

dispose of obsolete inventory as soon as practicable after such inventory has been identified as having no value. During fiscal 2004, the sale of inventory written down to zero cost amounted to approximately \$0.8 million, increasing gross margin as a percentage of sales by 0.6%. During fiscal 2003, we sold approximately \$1.0 million of inventory written down to zero cost, increasing gross margin as a percentage of sales by 0.9%. For fiscal year 2005, we anticipate gross profit as a percentage of sales to range from 46% to 50%; however, actual results may vary.

#### **SELLING, GENERAL AND ADMINISTRATIVE EXPENSE**

Selling, general and administrative (SG&A) expense during the fiscal year ended June 30, 2004 as compared to fiscal 2003 follows:

Thousands	<b>Fiscal years ended</b>		
	<b>June 30,</b>		<b>Increase/ (decrease)</b>
	<b>2004</b>	<b>2003</b>	
SG&A expense.....	\$ <u>32,504</u>	<u>33,608</u>	\$ <u>(1,104)</u>
As a percent of sales.....	<u>24.3%</u>	<u>29.1%</u>	

For the year ended June 30, 2004, SG&A expense decreased 3.3%, compared to the prior fiscal year, due primarily to the cost reduction efforts implemented in connection with the consolidation of operations during fiscal 2004, partially offset by the costs added as a result of the acquisition of SBS Canada in June 2003. For these reasons, together with increased sales, SG&A expense as a percentage of sales declined in fiscal 2004 compared with fiscal 2003.

#### **RESEARCH AND DEVELOPMENT EXPENSE**

Research and development (R&D) expense during fiscal 2004 as compared to the fiscal year ended June 30, 2003 follows:

Thousands	<b>Fiscal years ended</b>		
	<b>June 30,</b>		<b>Increase/ (decrease)</b>
	<b>2004</b>	<b>2003</b>	
R&D expense.....	\$ <u>20,552</u>	<u>18,077</u>	\$ <u>2,475</u>
As a percent of sales.....	<u>15.4%</u>	<u>15.6%</u>	

For the year ended June 30, 2004, R&D expense increased 13.7%, compared to the prior fiscal year, due primarily to the costs added as a result of the acquisition of SBS Canada in June 2003. Increasing our intellectual property is a key element of our growth strategy. During fiscal 2004, we introduced thirty-seven new products as we continue to implement this segment of our strategy. Research and development expenses fluctuate from period to period throughout the life cycle of our research and development efforts. As a percentage of sales, R&D expense during fiscal 2004 was in line with our current development plan and remained consistent with fiscal 2003 levels.

#### **EMPLOYEE SEVERANCE AND CONSOLIDATION COSTS**

On June 12, 2003, we announced that we would be closing our Carlsbad, California facility and consolidating its manufacturing operations into our St. Paul, Minnesota facility, centralizing all manufacturing in the United States into one facility. This consolidation was completed in August, 2003. As a result of these actions, we recorded employee severance and consolidation costs totaling approximately \$2.4 million during fiscal 2004. These costs included the following:

- Employee severance and related costs of \$470,000 (recorded over the remaining service period in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*) due to the reduction of our workforce. There were no amounts remaining to be paid at June 30, 2004.
- Other consolidation costs of \$530,000 (recorded as incurred in accordance with SFAS 146) as a result of the consolidation of our communications operations into other facilities. There were no amounts remaining to be paid at June 30, 2004.

- Lease termination costs of \$1.4 million, (recorded on the cease use date in accordance with SFAS 146) as a result of the closure of our Carlsbad, California facility in August 2003. The lease termination costs represent the estimated fair value of the remaining future lease payments and related obligations, net of sublease income, over the term of the lease. The remaining lease obligations are expected to be paid monthly through April 2006.

For fiscal 2003, we recorded employee severance and consolidation costs totaling \$1.7 million. This total includes approximately \$1.1 million recorded as a result of the announcement of the closure of our Carlsbad California facility, of which \$290,000 was employee severance and related costs and \$841,000 was a leasehold improvement impairment charge. The fiscal 2003 total also includes \$412,000 of employee severance costs due to the elimination of 53 employees as a result of the economic and market conditions facing our telecommunications customers and \$186,000 of lease termination costs as a result of our decision to exit certain locations during 2003. There were no amounts remaining to be paid at June 30, 2004.

#### **AMORTIZATION OF INTANGIBLE ASSETS**

For the fiscal year ended June 30, 2004, amortization of intangible assets was \$2.1 million, compared to \$1.9 million for fiscal 2003. Amortization expense increased in fiscal 2004 due to the amortization of the purchased identifiable intangible assets recorded in connection with the acquisition of SBS Canada (formerly Avvida Systems) in June 2003. Also, in fiscal 2003, amortization expense included a write-down of \$136,000 recorded in connection with a prepaid license agreement for a product that SBS determined during the quarter ended September 30, 2002 would not be brought to market.

#### **INTEREST AND OTHER INCOME, NET**

For the year ended June 30, 2004, net interest and other income of \$634,000, included interest received in September 2003 in connection with income tax refunds of payments made in prior periods of approximately \$250,000. Excluding the interest on the tax refunds in fiscal 2004, net interest and other income represented primarily interest income associated with surplus cash, which declined from fiscal 2003 levels as a result of lower interest rates.

#### **FOREIGN EXCHANGE LOSSES**

For fiscal 2004 and 2003, foreign exchange losses of \$348,000 and \$207,000, respectively, represent primarily realized and unrealized losses on certain inter-company transactions that are denominated in non-functional currencies due to changes in currency exchange rates as a result of the weakening of the U.S. dollar during fiscal 2004 and 2003.

#### **INCOME TAX EXPENSE**

For the year ended June 30, 2004 and 2003, income tax expense was recorded using worldwide effective tax rates of 30.0% and 32.8%, respectively. The change in the estimated worldwide effective income tax rate was due to the impact of a shift in the mix of pre-tax income from domestic and foreign sources together with benefits realized as a result of the implementation of tax planning strategies during the fourth quarter of fiscal 2004.

In assessing the realizability of the Company's deferred tax assets of approximately \$13.2 million at June 30, 2004, management considers projected future sources of taxable income together with tax planning strategies. As of June 30, 2004, the valuation allowance, which increased approximately \$1.3 million during fiscal 2004, applies to certain U.S. State operating loss and tax credit carryforwards that, in the opinion of management, may expire unused due to uncertainty regarding future taxable income. Based on SBS' historical taxable transactions, the timing of the reversal of existing temporary differences, and the evaluation of tax planning strategies, management believes it is more likely than not that SBS' future taxable income will be sufficient to realize the benefit of the remaining deferred tax assets existing at June 30, 2004.

SBS generally does not record deferred income taxes on the undistributed earnings of its foreign subsidiaries in accordance with the indefinite reversal criterion in APB Opinion No. 23, "Accounting for Income Taxes – Special Areas", because the Company currently does not expect those unremitted earnings to reverse and become taxable in the foreseeable future. Upon distribution of these earnings, which amounted to approximately \$26.4 million at June 30, 2004, SBS may be subject to U.S. income taxes and foreign withholding taxes. It is not practical, however, to estimate the amount of taxes that may be payable on the eventual remittance of these earnings.

#### **CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE**

For the year ended June 30, 2003, we recorded a transitional impairment charge of \$9.5 million (\$6,058,000 net of tax), reported as a cumulative effect of change in accounting principle, as a result of our adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, (SFAS 142) effective July 1, 2002.

## EARNINGS PER SHARE

For the year ended June 30, 2004, net income per common share and net income per common share – assuming dilution was \$0.34. This compares to income per share and income per share – assuming dilution before the cumulative effect of the change in accounting principle of \$0.11 during the fiscal year ended June 30, 2003. Net loss per share and net loss per common share – assuming dilution was \$(0.30) during the fiscal year ended June 30, 2003, including the impact of the cumulative effect of change in accounting for goodwill of \$(0.41) per common share as a result of our adoption of SFAS 142 effective July 1, 2002.

## Review of Business Segments

As a result of changes in management responsibility, the Company's desire to enhance its regional-based sales and service to the Company's European customers and the June 2003 acquisition of SBS Canada (formerly Avvida Systems), the Company changed its reportable segments to a structure based on geographic markets. This change has enabled management to focus on regional market development, alignment of sales channels with customers' product needs, and enhancement of customer service and satisfaction.

The Company is engaged in the design, research, development, integration and production of embedded computer products and we operate worldwide through two operating segments: the Americas Group and the Europe Group. Both the Americas Group and the Europe Group offer our complete portfolio of embedded computer products to customers in the government, commercial and communications end markets. Each segment has management who report directly to the Company's Chief Executive Officer and its own sales and distribution channels. The Americas Group consists of the Company's operations based in the United States and Canada, and most recently in Shenzhen, China. This includes the engineering, test, and assembly activities in Albuquerque, New Mexico; Mansfield, Massachusetts; Newark, California; Raleigh, North Carolina; St. Paul, Minnesota; and Waterloo, Ontario, Canada; the manufacturing operations located in St. Paul, Minnesota; and the sales and technical support activities based in Shenzhen, China. The Europe Group consists of the Company's operations based in Germany which include the engineering, test, assembly, and manufacturing activities located in Augsburg and Mindelheim, Germany.

The following is a discussion of sales to external customers and segment profit (loss) for each reportable segment. We measure the results of operations for segments (Segment Profit (Loss)) based on income (loss) before income taxes and the cumulative effect of change in accounting principle and before:

- the allocation of corporate overhead expenses other than marketing costs;
- substantially all amortization expense associated with acquisitions; and
- interest income earned on U.S. operations cash balances.

### AMERICAS GROUP

Thousands	Fiscal Years Ended		
	June 30,		%
	2004	2003	
Sales to External Customers.....	\$ 97,066	94,268	3.0%
Segment Profit .....	\$ 12,864	10,073	27.7%

*Sales to External Customers.* For the year ended June 30, 2004, sales to external customers increased approximately \$2.8 million, or 3.0%, compared to the prior fiscal year, as unit shipments increased across all the Group's product lines, with the exception of telecommunications product shipments which declined from prior year levels. The Group's sales to external customers for the year ended June 30, 2004 exclude approximately \$3.5 million of sales that, after the transfer of sales and support for our European customers to our German operations, were included in sales for the Europe Group. Sales contributed by the acquisition of SBS Canada (formerly Avvida Systems) in June 2003 were approximately \$1.1 million for the year ended June 30, 2004.

*Segment Profit.* Segment profit increased \$2.8 million, or 27.7%, for the year ended June 30, 2004, compared to the prior fiscal year. Segment profit in fiscal 2004 increased over fiscal 2003 levels as a result of a change in sales mix to higher margin products, together with reduced SG&A expenses due to management actions taken as a result of market conditions impacting the Company during fiscal 2003 and 2002. In addition, segment profit in fiscal 2004 was unfavorably impacted by approximately \$2.4 million of employee severance and consolidation costs recorded from the consolidation of our communications operations that resulted in the closure of our Carlsbad, California facility in August 2003. This compares to approximately \$1.7 million of employee severance and consolidation costs recorded during fiscal 2003, of which \$1.1 million was due to our announcement to

consolidate our communications operations resulting in the closure of our Carlsbad, California facility during the fourth fiscal quarter of 2003, \$412,000 of employee severance costs due to workforce reductions implemented as a result of the depressed market conditions impacting our communications market customers throughout fiscal 2003, and \$186,000 of lease termination costs as a result of our decision to exit certain locations during 2003. For these reasons, segment profit as a percentage of sales to external customers increased to 13.3% for fiscal 2004, compared with 10.7% for fiscal 2003.

#### EUROPE GROUP

Thousands	Fiscal Years Ended		
	June 30,		%
	2004	2003	
Sales to External Customers.....	\$ 36,808	21,253	73.2%
Segment Profit.....	\$ 7,540	5,138	46.7%

*Sales to External Customers.* Unit shipments of the Group's products increased resulting in increased sales to external customers. For the fiscal year ended June 30, 2004, sales to external customers increased \$15.6 million, compared to the prior fiscal year, of which approximately \$2.7 million was the result of changes in currency exchange rates used to translate the Group's financial statements to U.S. dollars. The Group's sales to external customers for fiscal 2004 included an increase of approximately \$2.5 million of sales that, before the transfer of sales and support for our European customers to our German operations, would have been included in sales of the Americas Group.

*Segment Profit.* For the year ended June 30, 2004, segment profit increased \$2.4 million, or 46.7%, compared to the prior year, due primarily to the increase in sales, offset partially by an increase in SG&A and R&D expenses commensurate with the growth in the business. For these reasons, segment profit as a percentage was 20.5% for fiscal 2004, compared to 24.2% for fiscal 2003.

#### Year Ended June 30, 2003 Compared to Year Ended June 30, 2002

(References to fiscal 2003 and fiscal 2002 relate to the fiscal years ended on June 30)

#### SALES

For the year ended June 30, 2003, sales decreased 3%, or \$3.4 million, from \$118.9 million for the year ended June 30, 2002, to \$115.5 million. In fiscal 2003, by end market, sales to government customers increased 19.9%, or \$10.0 million, sales to commercial customers declined 4.9%, or \$1.9 million, and sales to communications customers decreased 39.7%, or \$11.4 million, all compared with fiscal 2002 sales levels. During fiscal 2003, we continued to experience the effects of the economic and market conditions that were negatively impacting our telecommunications infrastructure customers.

#### GROSS PROFIT

For the year ended June 30, 2003, gross profit increased 35%, or \$14.9 million, from \$42.6 million for the year ended June 30, 2002, to \$57.5 million. The increase in gross profit was primarily due to significant inventory write-downs and other charges recorded in fiscal 2002. In fiscal 2002, we recorded \$15.1 million of inventory write-downs and \$185,000 of expenditures associated with our manufacturing consolidation and cost reduction efforts. The write-downs consisted of inventory associated with programs that were not anticipated to come back to their previous forecasts, inventory associated with our decision to exit the legacy PCI chassis product line, inventory associated with products that we will no longer market, and reduced demand for certain Communications and Enterprise Group products. Additionally, the implementation of a new inventory management methodology associated with the consolidation of our manufacturing operations, contributed to the inventory write-down in fiscal 2002. The consolidation efforts and new inventory methodology resulted in a reduction in required inventory levels. For these reasons, gross profit as a percent of sales for fiscal 2003 improved to 49.8% compared with 35.9% for fiscal 2002 (48.7% excluding the \$15.3 million of charges noted above). During the year ended June 30, 2003, we sold approximately \$1.0 million of inventory that had been previously written down to zero cost, increasing gross margin as a percentage of sales by 0.9%.

#### SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

For the year ended June 30, 2003, selling, general and administrative (SG&A) expense decreased 13.4%, or \$5.2 million from \$38.8 million for the year ended June 30, 2002, to \$33.6 million. This decrease was primarily due to the benefits realized from the implementation of cost reduction efforts which began during fiscal 2002 and continued in fiscal 2003. SG&A expense as a

percentage of sales decreased to 29.1% in the year ended June 30, 2003 from 32.7% in the year ended June 30, 2002, primarily as a result of the cost reduction efforts, partially offset by reduced sales levels.

#### **RESEARCH AND DEVELOPMENT EXPENSE**

For the year ended June 30, 2003, research and development (R&D) expense decreased 2.1%, or \$384,000 from \$18.5 million for the year ended June 30, 2002, to \$18.1 million. This decrease was primarily due to the cost reduction efforts implemented in both fiscal 2003 and fiscal 2002, partially offset by the addition of research and development employees resulting from the acquisition of the assets of Essential Communications completed in March 2002. For the year ended June 30, 2003, R&D expense as a percentage of sales remained consistent at 15.6% compared with 15.5% in the year ended June 30, 2002.

#### **EMPLOYEE SEVERANCE AND CONSOLIDATION COSTS**

For the year ended June 30, 2003, we recorded employee severance and consolidation costs of \$1.7 million, which include the following:

- a charge for the impairment of leasehold improvements of approximately \$841,000 recorded in the fourth quarter;

On June 12, 2003, we announced that we would be closing our Carlsbad, California facility and consolidating its manufacturing operations into our St. Paul, Minnesota facility, centralizing all manufacturing in the United States to one facility. This consolidation was completed in August, 2003.

- employee severance and related costs of approximately \$702,000; and

Due to the economic and market conditions facing our telecommunications customers, on July 22, 2002, we notified 19 full and part-time employees at our Madison, Wisconsin engineering design center that their jobs had been eliminated. Additionally, for the same reason, on September 30, 2002, we notified 22 employees of that their jobs were being eliminated. We also incurred severance costs for 12 other employees who were notified that their jobs had been eliminated. As a result of these actions, we incurred \$412,000 of employee severance costs, of which there were no costs remaining to be paid as of June 30, 2003.

As a result of the June 2003 announcement of the closure of our Carlsbad, California facility, we recorded severance and related costs of approximately \$290,000, due primarily to the planned reduction of the workforce in August 2003. Of this amount, approximately \$224,000 was accrued at June 30, 2003, and we paid all of these costs during the year ended June 30, 2004.

- lease termination costs of approximately \$186,000, as a result of our decision to exit certain locations.

These costs compare with total employee severance and related costs of approximately \$3.2 million incurred during fiscal 2002, as a result of other actions taken by management in response to unfavorable economic and market conditions.

#### **IMPAIRMENT OF INTANGIBLE ASSETS**

We recorded no intangible asset impairment charges in fiscal 2003, compared to impairment charges of \$13.0 million recorded in fiscal 2002. For the year ended June 30, 2002, \$2.7 million of the \$13.0 million asset impairment charge represented the write-off of the remaining goodwill recorded in connection with the acquisition of SBS Technologies, Inc., Industrial Computers (formerly Micro Alliance) in November 1997. This write-off was the result of SBS' decision in the quarter ended December 31, 2001 to exit the PCI chassis business. The remaining \$10.3 million represented the write-down of goodwill and other identifiable intangible assets associated with the acquisition of SDL in April of 2000. The write-down, which occurred in the fourth quarter of fiscal 2002, was based on SBS' projection of undiscounted future operating cash flows. This evaluation indicated that these cash flows were not sufficient to recover the carrying amounts of the goodwill and other identifiable intangible assets. As a result, the impairment charge was recorded to the extent that the carrying value exceeded fair value of the assets. The evaluation was performed as a result of continued order cancellations and a continued decline in sales and bookings in the fourth quarter of fiscal 2002.

#### **AMORTIZATION OF GOODWILL**

There was no goodwill amortization expense in fiscal 2003, whereas goodwill amortization amounted to approximately \$4.5 million for the year ended June 30, 2002. Effective July 1, 2002, we adopted SFAS 142 and no longer amortize goodwill. As of the date of adoption, we had unamortized goodwill of approximately \$20.5 million, subject to the transition provisions of SFAS

142. Included in the determination of net loss in fiscal 2003 is a transitional goodwill impairment charge of \$9.5 million (\$6.1 million net of income taxes), which is reported as a cumulative effect of change in accounting principle, as a result of the Company's adoption of SFAS 142. We completed step 1 of our transitional impairment analysis during the quarter ended December 31, 2002 and noted an indication of potential impairment for two reporting units. Accordingly, we completed step 2 of the required transitional impairment analysis during the fourth quarter of fiscal 2003 and determined that the carrying values of goodwill of the Communications and Enterprise reporting unit and the Commercial reporting unit (both components of the Americas Group segment) were in excess of their implied fair value as of July 1, 2002. We completed our annual goodwill impairment test for fiscal 2003 as of April 1, 2003 and found no indication of impairment.

#### **AMORTIZATION OF INTANGIBLE ASSETS**

For the year ended June 30, 2003, amortization of intangible assets was \$1.9 million, compared to \$3.0 million for the same period of fiscal 2002. The decrease was primarily due to the intangible asset impairment charges recorded during fiscal 2002 discussed previously.

#### **INTEREST AND OTHER INCOME, NET**

For the year ended June 30, 2003, net interest and other income of \$434,000 consisted primarily of interest income associated with surplus cash. For the year ended June 30, 2002, net interest and other income of \$631,000 consisted primarily of a recovery from insurance of \$307,000, and interest income associated with surplus cash, partially offset by a \$323,000 charge related to an other-than-temporary decline in our investment in a software company.

#### **FOREIGN EXCHANGE LOSSES**

For the year ended June 30, 2003, net foreign exchange losses of \$207,000 were principally attributable to changes in exchange rates relating to payments made by SBS to a foreign subsidiary for marketing and other corporate costs borne by the foreign subsidiary. For fiscal 2002, net foreign exchange losses were not significant.

#### **INCOME TAX EXPENSE (BENEFIT)**

For the years ended June 30, 2003 and 2002, income tax expense (benefit) from continuing operations (excluding taxes allocated to the cumulative effect of the change in accounting principle of \$3.4 million) represented effective rates of 32.8% and (35.6)%, respectively. The change in the effective income tax rate was due to the impact of a shift in the mix of pre-tax income from domestic and foreign sources coupled with benefits realized from tax planning strategies in excess of previous estimates. We recorded a tax benefit related to the net loss in fiscal 2002 due to our ability to realize the benefit through a tax loss carry back to prior periods.

#### **EARNINGS PER SHARE**

For the year ended June 30, 2003, income per common share and income per common share – assuming dilution, before the cumulative effect of the change in accounting principle, was \$0.11 compared to a loss per common share and a loss per common share – assuming dilution, before the cumulative effect of the change in accounting principle, of \$(1.67) for the same period in fiscal 2002. The per share impact of the transitional impairment charge as a result of the Company's adoption of SFAS 142, reported as a cumulative effect of change in accounting principle in fiscal 2003, was a loss per common share and a loss per common share – assuming dilution of \$(0.41). For the year ended June 30, 2003, net loss per common share and net loss per common share – assuming dilution were \$(0.30) compared to \$(1.67) for the same period in fiscal 2002.

#### **Review of Business Segments**

During fiscal 2004, we changed our reportable segments to a structure based on geographic markets as a result of changes in management responsibility, our desire to enhance our regional-based sales and service to our European customers, and the June 2003 acquisition of SBS Canada (formerly Avvida Systems). This change has enabled management to focus on regional market development, alignment of sales channels with customers' product needs, and enhancement of customer service and satisfaction.

The Company is engaged in the design, research, development, integration and production of embedded computer products and we operate worldwide through two operating segments: the Americas Group and the Europe Group. Both the Americas Group and the Europe Group offer our complete portfolio of embedded computer products to customers in the government, commercial and communications end markets. Each segment has management who report directly to our Chief Executive Officer and its own sales and distribution channels. The Americas Group consists of our operations based in the United States and Canada, including the

engineering, test, and assembly activities in Albuquerque, New Mexico; Mansfield, Massachusetts; Newark, California; Raleigh, North Carolina; St. Paul, Minnesota; and Waterloo, Ontario, Canada; and the manufacturing operations located in St. Paul, Minnesota. The Europe Group consists of our operations based in Germany, which include the engineering, test, assembly, and manufacturing activities located in Augsburg and Mindelheim, Germany.

The following is a discussion of sales to external customers and segment profit (loss) for each reportable segment. We measure the results of operations for segments (Segment Profit (Loss)) based on income (loss) before income taxes and the cumulative effect of change in accounting principle and before:

- the allocation of corporate overhead expenses other than marketing costs;
- substantially all amortization expense associated with acquisitions; and
- interest income earned on U.S. operations cash balances.

#### AMERICAS GROUP

Thousands	Fiscal Years Ended		
	June 30,		%
	2003	2002	
Sales to External Customers.....	\$ 94,268	106,288	-11.3%
Segment Profit .....	\$ 10,073	(5,976)	-268.6%

*Sales to External Customers.* For the year ended June 30, 2003, sales to external customers decreased approximately \$12.0 million, or 11.3%, compared to the prior fiscal year. Unit shipments in fiscal 2003 decreased slightly from fiscal 2002 levels for general purpose input/output products, computer connectivity and expansion products, and avionics and telemetry products. We believe the uncertainty caused by the military activity in the Middle East during the quarter ended March 31, 2003 adversely affected the placement of some customer orders. Unit shipments for the Group's telecommunications products declined from prior year levels. This decrease was due principally to the economic and market conditions negatively affecting the telecommunications market. We continued to experience the effects of reduced booking activities compared to prior periods, and delays of existing backlog orders and prior order cancellations by our telecommunications infrastructure customers.

*Segment Profit.* For the year ended June 30, 2003, the increase in segment profit was due to a change in sales mix to products with higher gross margins, decreases in SG&A expenses as a result of the cost reduction efforts implemented during fiscal 2003 and 2002 and the significant inventory write-downs recorded in fiscal 2002, partially offset by increased R&D costs resulting from the Essential Communications asset acquisition in March 2002. Total inventory write-downs of \$15.1 million and \$185,000 of expenditures associated with our manufacturing consolidation and cost reduction efforts were recorded in fiscal 2002. The inventory write-downs in fiscal 2002 were associated with programs that were not anticipated to come back to their previous forecasts, products that will no longer be marketed and excess component parts based on the implementation of the new inventory management methodology associated with the consolidation of our manufacturing operations and our decision to exit our legacy PCI chassis product line. In fiscal 2003, we recorded employee severance and consolidation costs due to the cost reduction efforts implemented in response to the economic and market conditions negatively affecting the Group and the announcement, on June 12, 2003, of the closure of our Carlsbad, California facility and the consolidation of its manufacturing operations into our St. Paul, Minnesota facility, which we completed in August, 2003. For these reasons, segment profit (loss) as a percent of sales to external customers improved to 10.7% for the year ended June 30, 2003, from (5.6)% for the same period of fiscal 2002.

#### EUROPE GROUP

Thousands	Fiscal Years Ended		
	June 30,		%
	2003	2002	
Sales to External Customers.....	\$ 21,253	12,568	69.1%
Segment Profit.....	\$ 5,138	3,287	56.3%

*Sales to External Customers.* Unit shipments of the Group's computer processor products increased resulting in increased sales to external customers. For the fiscal year ended June 30, 2003, sales to external customers increased \$8.7 million, compared to the prior fiscal year.

*Segment Profit.* For the year ended June 30, 2004, segment profit increased \$1.9 million, or 56.3%, compared to the prior year, due primarily to the increase in sales, offset partially by an increase in SG&A and R&D expenses commensurate with the growth in the business. For these reasons, segment profit as a percentage of sales to external customers was 24.2% for fiscal 2003, compared to 26.2% for fiscal 2002.

### **Liquidity, Capital Resources and Financial Condition**

Our objective is to maintain adequate financial resources and liquidity to finance the operations of the Company. We use a combination of proceeds from the sale or issuance of equity securities and internally generated funds to finance our working capital requirements, capital expenditures, acquisitions, and operations.

Our cash balance of \$47.9 million at June 30, 2004 represents an increase of \$10.8 million during the year ended June 30, 2004. Net cash flows from operating activities and proceeds from the exercise of employee stock options were the principal sources of funding, and cash was used for a mix of activities including working capital needs and capital expenditures. We anticipate that this trend will continue in the fiscal year ending June 30, 2005, however, future cash inflows as a result of employee stock option exercises are difficult to predict with certainty.

### **Cash Flows**

Changes to our cash balance during the years ended June 30, 2004, 2003 and 2002 follows:

#### **Comparison of Condensed Consolidated Statements of Cash Flows**

	Years Ended June 30,		
	2004	2003	2002
<b>Cash Flow Provided by (Used in)</b>			
Operating activities.....	\$ 8,289	16,832	20,571
Investing activities.....	(3,283)	(4,390)	(4,359)
Financing activities.....	5,646	(456)	(1,433)
<b>Net effect on cash from:</b>			
Exchange rates.....	161	333	298
Cumulative effect of change in accounting principle.....	--	6,058	--
<i>Thousands</i>			

#### *Operating Activities*

Cash flows from operating activities were principally the result of the Company's net income, changes in working capital and the impact of non-cash and non-operating activities including depreciation and amortization of \$6.0 million in fiscal 2004.

The underlying drivers of the changes in working capital during fiscal 2004 were as follows:

- The increase in accounts receivable used operating cash of \$371,000, prior to foreign currency translation adjustments of \$241,000, due principally to the growth in sales.
- The increase in inventory used operating cash of \$9.1 million, prior to foreign currency translation adjustments of \$319,000. Throughout fiscal 2004, our customers required shorter lead times for our products, resulting in a need to maintain higher levels of inventory. However, we believe that we have reached a level of inventory necessary to satisfy customers' requirements as of June 30, 2004.
- We recorded an income tax benefit associated with the exercise of employee stock options of approximately \$1.0 million in fiscal 2004. In addition, we received income tax refunds, net of tax payments, of \$0.7 million as a result of the carryback of tax losses to prior tax years.
- Our total liabilities increased by \$3.0 million in fiscal 2004, which is consistent with the growth in our operations and we continue to have no bank debt as of June 30, 2004.

### *Investing Activities*

Our principal recurring investing activity is the funding of capital expenditures necessary to support the growth of our business and to enhance the productivity of our operations. During fiscal 2004, we used \$3.4 million for the purchase of property and equipment and received an income tax refund which exceeded the amount recorded at the acquisition of SBS Canada by \$104,000, which was recorded as a reduction to goodwill.

### *Financing Activities*

We received proceeds of \$5.6 million from the issuance of common stock associated with the exercise of employee stock options in fiscal 2004.

### *Exchange Rates*

Changes in foreign currency exchange rates impacted beginning cash balances during the year ended June 30, 2004 by approximately \$161,000. Due to the Company's international operations, where transactions are recorded in functional currencies other than the U.S. dollar, the effects of changes in foreign currency exchange rates on existing cash balances during any given period results in amounts on the consolidated statements of cash flows that may not reflect the changes in the corresponding accounts on the consolidated balance sheets.

### **Cash Requirements**

We believe that our internally generated cash flows will provide us with sufficient capital resources and liquidity to manage our operations, meet our contractual obligations, and fund capital expenditures, excluding acquisitions, for at least the next twelve months. Based upon our assessment of future cash needs and sources of cash as of the date of this report, we believe that our liquidity needs do not require us to maintain a credit facility at this time.

Because long-term cash flow cannot be predicted with certainty, it is possible that SBS could require external financing in the future, and that such financing may not be available on terms acceptable to SBS or at all.

### **Capital Resources**

As of the date of this report, SBS does not have any material capital expenditure commitments.

### **Contractual Obligations**

SBS is committed under non-cancelable operating leases for buildings and equipment that expire at various dates through fiscal 2015. The following is a schedule of our contractual obligations at June 30, 2004:

#### **CONTRACTUAL OBLIGATIONS**

Thousands	Payments due by fiscal years ending June 30,				
	Total	2005	2006 - 2007	2008 - 2009	2010 & beyond
Operating lease obligations.....	\$ 10,926	2,358	2,772	1,414	4,382
<b>Total</b>	<b>\$ 10,926</b>	<b>2,358</b>	<b>2,772</b>	<b>1,414</b>	<b>4,382</b>

### **Off-Balance Sheet Arrangements**

As of June 30, 2004, we have no transactions that would be considered off-balance sheet arrangements in accordance with the definition under SEC rules.

### **Inflation**

For the periods ended June 30, 2004, 2003 and 2002, there was no significant impact from inflation.

### **Business Outlook**

Consistent with our press release dated August 10, 2004, we are pleased with the progress made in implementing our strategic plan. As a team, we completed a major restructure of the company and developed an outward looking, aggressive approach to the market. As an example, we opened a sales and technical support office in Shenzhen, China in June 2004. In order for SBS to continue to maintain and increase organic growth, we believe we must expand our global presence and maintain our market

diversity.

For the past two years, we maintained an annual book-to-bill ratio of greater than one-to-one. Throughout fiscal 2004, our customers required shorter lead times for our products, increasing our turn business and resulting in more extensive variability of our bookings.

As we progress through calendar 2004 and start fiscal year 2005, we believe the government market will remain strong. We experienced growth of 12.4% in this market in fiscal year 2004, and, as planned, the majority of design wins and new opportunities were for system level solutions. The military budget is still heavily focused on unmanned vehicles and upgrade programs. Both of these are areas where SBS is positioned to win new business. Sales to communications customers increased 49.4% in fiscal year 2004, and we expect additional growth in fiscal year 2005. The wireless and network monitoring markets, both traditionally served by SBS, continue to show positive growth, and, with the addition of Advanced Telecom Computing Architecture based products we anticipate new opportunities. Sales to commercial customers increased 6.1% in fiscal year 2004. We expect steady demand from semiconductor and medical equipment manufacturers, and we are optimistic that we will see growth in the industrial automation market in fiscal year 2005.

Looking forward, based on our forecasts, existing order backlog, and the timing of new orders, we expect sales for the quarter ending September 30, 2004 to be between \$36 million and \$37 million, a 35% to 39% increase from the first quarter of fiscal 2004; however, actual results may vary. Further, we anticipate growth in sales throughout the remainder of fiscal year 2005 resulting in total sales for the year ending June 30, 2005 to be between \$150 million and \$160 million, all from organic growth; however, actual results may vary.

The assumptions we based our sales projections on include the continued health of the end markets we serve, the expectation of several government system design wins to begin production, and for sales to Applied Materials and Ericsson to continue at the same dollar level as in fiscal year 2004, approximately \$13.2 million and \$10.3 million, respectively. Based on forecasts from these two customers, and the health of the end markets we serve as evidenced by our strong quoting activity and design win funnel, we believe these assumptions are valid for the coming year. We believe that our new product and business development efforts will expand opportunities in each end market contributing to our performance.

Management expects that corporate representatives of SBS will meet privately during the year with investors, investment analysts, the media and others, and may reiterate the Business Outlook published in this Form 10-K. At the same time, this Form 10-K and the included Business Outlook will remain publicly available on our Web site ([www.sbs.com](http://www.sbs.com)). Unless a notice stating otherwise is published, the public can continue to rely on this Business Outlook as representing our current expectations on matters covered.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The Company's principal investment is cash invested in either money market accounts or in overnight repurchase agreements. Due to the nature of these investments, we believe that the market risk related to these investments is minimal. As a result of the Company's German and Canadian operating and financing activities, we are exposed to market risk from changes in foreign currency exchange rates. At present we do not utilize any derivative instruments to manage this risk.

*Currency translation.* The results of operations of our foreign subsidiaries are translated into U.S. dollars at the average exchange rates for each period concerned. The balance sheets of foreign subsidiaries are translated into U.S. dollars at the closing exchange rates. Any adjustments resulting from the translation are recorded as translation adjustments in other comprehensive income. As of June 30, 2004, assets of foreign subsidiaries constituted approximately 31% of total assets. Foreign currency exchange rate exposure is most significant with respect to the euro. For the fiscal year ended June 30, 2004, net sales were positively impacted by the appreciation of foreign currencies, primarily the euro, versus the U.S. dollar by approximately \$2.7 million.

*Currency transaction exposure.* Currency transaction exposure arises where a business or company makes actual sales and purchases in a currency other than its own functional currency. We generally source raw materials and sell our products within our local markets in their functional currencies and therefore have limited currency transaction exposure.

#### **Item 8. Financial Statements and Supplementary Data**

### **Report of Independent Registered Public Accounting Firm**

The Board of Directors  
SBS Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of SBS Technologies, Inc. and subsidiaries as of June 30, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SBS Technologies, Inc. and subsidiaries as of June 30, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2004 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, effective July 1, 2002.

KPMG LLP

Albuquerque, New Mexico  
August 9, 2004

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	Thousands (except share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 47,943	37,130
Receivables, net	23,776	23,164
Inventories	26,249	16,816
Income tax receivable	983	4,830
Deferred income taxes	1,351	1,629
Prepaid expenses	1,573	1,661
Other current assets	332	431
Total current assets	102,207	85,661
Property and equipment, net	7,979	8,462
Goodwill	16,734	16,124
Intangible assets, net	4,764	6,906
Deferred income taxes	13,173	11,086
Other assets	279	371
Total assets	\$ 145,136	128,610
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 6,854	3,990
Accrued representative commissions	889	688
Accrued compensation	4,893	4,595
Accrued severance and consolidation costs	870	224
Other current liabilities	1,986	2,977
Total current liabilities	15,492	12,474
Other long-term liabilities	17	29
Total liabilities	15,509	12,503
Commitments and contingencies (notes 10, 12, 16 and 17)		
Stockholders' equity:		
Common stock, no par value; 200,000,000 shares authorized; 15,496,949 and 14,989,248 issued and outstanding at June 30, 2004 and 2003, respectively	96,601	89,916
Unearned compensation	(29)	(37)
Accumulated other comprehensive income	1,891	257
Retained earnings	31,164	25,971
Total stockholders' equity	129,627	116,107
Total liabilities and stockholders' equity	\$ 145,136	128,610

See accompanying notes to consolidated financial statements

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Years ended June 30,		
	2004	2003	2002
	Thousands (except per share amounts)		
Sales	\$ 133,874	115,521	118,856
Cost of sales	<u>69,145</u>	<u>58,002</u>	<u>76,228</u>
Gross profit	64,729	57,519	42,628
Selling, general and administrative expense	32,504	33,608	38,817
Research and development expense	20,552	18,077	18,461
Employee severance and consolidation costs	2,400	1,729	3,232
Impairment of intangible assets	—	—	13,005
Amortization of goodwill	—	—	4,523
Amortization of intangible assets	<u>2,141</u>	<u>1,940</u>	<u>3,002</u>
Operating income (loss)	<u>7,132</u>	<u>2,165</u>	<u>(38,412)</u>
Interest and other income, net	634	434	631
Foreign exchange losses	<u>(348)</u>	<u>(207)</u>	<u>(29)</u>
	<u>286</u>	<u>227</u>	<u>602</u>
Income (loss) before income taxes and cumulative effect of change in accounting principle	7,418	2,392	(37,810)
Income tax expense (benefit)	<u>2,225</u>	<u>784</u>	<u>(13,450)</u>
Income (loss) before cumulative effect of change in accounting principle	5,193	1,608	(24,360)
Cumulative effect of change in accounting principle (net of income tax benefit of \$3,412)	—	<u>(6,058)</u>	—
Net income (loss)	<u>\$ 5,193</u>	<u>(4,450)</u>	<u>(24,360)</u>
 Earnings per share data:			
Net income (loss) per share:			
Income (loss) before cumulative effect	\$ 0.34	0.11	(1.67)
Cumulative effect of change in accounting principle	—	<u>(0.41)</u>	—
Net income (loss)	<u>\$ 0.34</u>	<u>(0.30)</u>	<u>(1.67)</u>
Net income (loss) per share – assuming dilution:			
Income (loss) before cumulative effect	\$ 0.34	0.11	(1.67)
Cumulative effect of change in accounting principle	—	<u>(0.41)</u>	—
Net income (loss)	<u>\$ 0.34</u>	<u>(0.30)</u>	<u>(1.67)</u>

See accompanying notes to consolidated financial statements

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**Years ended June 30, 2004, 2003 and 2002**

	<b>Common Stock</b>		<b>Accumulated other Compre- hensive income (loss)</b>	<b>Retained earnings</b>	<b>Total Stock- holders'</b>	<b>Compre- hensive income (loss)</b>
	<b>Shares</b>	<b>Amount</b>	<b>Unearned Compen- sation</b>		<b>Stock- holders'</b>	
Thousands (except share amounts)						
<b>Balances at June 30, 2001</b>	14,522,080	\$ 85,476	\$ (478)	\$ (5,983)	\$ 54,781	\$ 133,796
Exercise of stock options	179,129	1,555	—	—	—	1,555
Stock-based compensation	—	45	56	—	—	101
Stock repurchased and retired	(42,500)	(488)	—	—	—	(488)
Cancellation of stock issued to officer under restricted stock awards	(30,000)	(422)	422	—	—	—
Income tax benefit from stock option exercises	—	172	—	—	—	172
Net loss	—	—	—	—	(24,360)	(24,360)
Other comprehensive income:						
Foreign currency translation adjustments	—	—	—	2,870	—	2,870
Comprehensive income	—	—	—	—	—	<u>\$ (21,490)</u>
<b>Balances at June 30, 2002</b>	14,628,709	86,338	—	(3,113)	30,421	113,646
Exercise of stock options	5,560	13	—	—	—	13
Restricted stock awards issued to directors	14,039	312	(110)	—	—	202
Stock-based compensation	—	—	73	—	—	73
Stock repurchased and retired	(46,000)	(321)	—	—	—	(321)
Acquisition of Avvida Systems, Inc.	386,940	3,574	—	—	—	3,574
Net loss	—	—	—	—	(4,450)	(4,450)
Other comprehensive income:						
Foreign currency translation adjustments	—	—	—	3,370	—	3,370
Comprehensive income	—	—	—	—	—	<u>\$ (1,080)</u>
<b>Balances at June 30, 2003</b>	14,989,248	\$ 89,916	(37)	257	25,971	116,107
Exercise of stock options	496,425	5,646	—	—	—	5,646
Restricted stock awards issued to directors	11,276	88	(88)	—	—	—
Stock-based compensation	—	—	96	—	—	96
Income tax benefit from stock option exercises	—	951	—	—	—	951
Net income	—	—	—	—	5,193	5,193
Other comprehensive income:						
Foreign currency translation adjustments	—	—	—	1,634	—	1,634
Comprehensive income	—	—	—	—	—	<u>\$ 6,827</u>
<b>Balances at June 30, 2004</b>	15,496,949	\$ 96,601	(29)	1,891	31,164	129,627

See accompanying notes to consolidated financial statements

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years ended June 30,		
	2004	2003	2002
		Thousands	
Cash flows from operating activities:			
Net income (loss)	5,193	(4,450)	(24,360)
Cumulative effect of change in accounting principle, net	—	6,058	—
Income (loss) before cumulative effect of change	\$ 5,193	1,608	(24,360)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	6,040	6,851	11,311
Impairment of intangible assets	—	—	13,005
Bad debt expense	81	458	799
Deferred income taxes	(1,794)	6,200	(10,204)
Income tax benefit from stock option exercises	951	—	172
(Gain) loss on disposition of assets	6	16	(15)
Foreign exchange losses	348	207	29
Non-cash compensation	80	—	—
Stock-based compensation, including restricted stock awards issued to directors	96	275	101
Changes in assets and liabilities (net of acquisitions):			
Receivables	(371)	(288)	4,328
Inventories	(9,114)	2,212	23,532
Income tax receivable	3,835	73	(1,473)
Prepaid expenses and other assets	217	(614)	2,545
Accounts payable	2,682	(667)	659
Accrued representative commissions	191	153	(324)
Accrued compensation	229	455	(330)
Accrued severance and consolidation costs	646	—	—
Other liabilities	(1,027)	(107)	796
Net cash provided by operating activities	8,289	16,832	20,571
Cash flows from investing activities:			
Business acquisitions, net of cash acquired	104	(2,643)	(1,033)
Acquisition of property and equipment	(3,387)	(1,431)	(3,334)
Purchase of license agreement	—	(325)	—
Other	—	9	8
Net cash used by investing activities	(3,283)	(4,390)	(4,359)
Cash flows from financing activities:			
Payments on notes payable	—	(148)	(2,500)
Repurchase and retirement of common stock	—	(321)	(488)
Proceeds from exercise of stock options	5,646	13	1,555
Net cash provided (used) by financing activities	5,646	(456)	(1,433)
Effect of exchange rate changes on cash	161	333	298
Net change in cash and cash equivalents	\$ 10,813	12,319	15,077
Cash and cash equivalents at beginning of period	37,130	24,811	9,734
Cash and cash equivalents at end of period	<u>\$ 47,943</u>	<u>37,130</u>	<u>24,811</u>

(Continued)

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)**

	Years ended June 30,		
	2004	2003	2002
	Thousands		
Supplemental disclosure of cash flow information:			
Interest paid	\$ —	12	15
Income taxes received, net	<u>\$ (727)</u>	<u>(4,256)</u>	<u>(1,991)</u>
Non-cash financing and investing activities – common stock issued for acquisition	\$ —	<u>3,574</u>	—
Summary of assets acquired and liabilities assumed through acquisitions			
Current assets	\$ —	437	603
Property and equipment, net	—	388	417
Deferred income taxes	—	280	224
Goodwill	—	3,496	—
Intangible assets	—	67	—
Identifiable intangible assets	—	2,170	364
Current liabilities	—	(473)	(149)
Deferred revenue	—	—	(426)
Notes payable	—	(148)	—

See accompanying notes to consolidated financial statements

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Overview**

SBS Technologies, Inc. (“SBS” or “the Company”) designs and builds open-architecture embedded computer products that enable original equipment manufacturers (OEM) to serve the government, commercial, and communications end markets. Embedded computer products are put inside or made part of larger systems to process information, control machines, move computer data between machines, and interact with people. SBS’ product line ranges from individual embedded computer components like Input/Output (I/O) modules, bus adapters, carrier cards, system enclosures, FPGA boards and single board computers, to network switches, blades and fully integrated systems, and many of these products are available in ruggedized or high availability versions. The Company’s products have application in diverse industries, including space and aviation, telecommunications, military and government, transportation, telemetry, robotics, networking, broadcasting, wireless communications and medical imaging. SBS has operations in New Mexico, Minnesota, North Carolina, California, Massachusetts, Germany, Canada and China.

**1) Summary of Significant Accounting Policies**

**(a) Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries. All inter-company accounts and transactions have been eliminated.

**(b) Cash Equivalents**

Temporary investments with original maturities of ninety days or less are classified as cash equivalents. At June 30, 2004, substantially all cash was held at two financial institutions.

**(c) Inventories**

Inventories are valued at standard cost, which approximates the lower of weighted average cost or market.

**(d) Property and Equipment**

Property and equipment are carried at cost. Depreciation of property and equipment is provided for by straight-line and accelerated methods over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the life of the lease or the estimated useful lives of the assets.

**(e) Goodwill and Other Intangible Assets**

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, “Accounting for Impairment or Disposal of Long-Lived Assets” (SFAS 144).

The Company conducts its annual impairment test as of April 1 of each fiscal year. To accomplish this, the Company is required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the test date. The Company is required to perform the second step of the impairment test if the carrying amount of a reporting unit exceeds its fair value. In this second step, the Company would compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill, both of which were measured as of the date of the test. The implied fair value of goodwill would be determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS 141, “Business Combinations.” The residual fair value after this allocation would be the implied fair value of the reporting unit goodwill.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, “Goodwill and Other Intangible Assets” (SFAS 142), as of July 1, 2002. In connection with SFAS 142’s transitional goodwill impairment evaluation, the Company performed an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. The implied fair value as of July 1, 2002 for two reporting units tested was less than the carrying amount requiring an impairment loss to be recognized.

Prior to the adoption of SFAS 142, goodwill was amortized on a straight-line basis over the expected period of benefit, generally 10 years, and assessed for recoverability by determining whether the amortization of the goodwill balance over its remaining life could be recovered through undiscounted future operating cash flows of the acquired operation. All other intangible assets were amortized on a straight-line basis, generally from 3 to 10 years. The amount of goodwill and other intangible asset impairment, if any, was measured based on projected discounted future operating cash flows using a discount rate reflecting the Company’s average cost of funds.

**(f) *Impairment of Long-Lived Assets***

The Company reviews long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with the provisions of SFAS No. 144. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized equal to the excess of the carrying amount of the asset over the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and the assets would no longer be depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets not subject to amortization are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset’s fair value.

The Company adopted SFAS 144 on July 1, 2002. Prior to the adoption of SFAS 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, “Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.”

**(g) *Revenue Recognition***

Revenue from product sales is recognized upon shipment to customers, provided the Company has received a valid purchase order, the price is fixed, title has transferred, collection of the associated receivable is reasonably assured, and there are no remaining significant obligations. Where customer acceptance provisions exist, the Company defers revenue recognition until acceptance by the customer unless the Company demonstrates the product meets the customer specified criteria upon shipment provided all other revenue recognition criteria have been met.

**(h) *Income Taxes***

SBS accounts for income taxes under the asset and liability method. Deferred income taxes are recognized for the tax consequences of differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities by applying enacted statutory tax rates applicable to future years. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the change.

**(i) *Financial Instruments***

SBS’ financial instruments are cash and cash equivalents, accounts receivable, and accounts payable. The carrying amounts of cash and cash equivalents, accounts receivable, and accounts payable, because of their nature, approximate fair value.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**(j) Reclassifications**

Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation.

**(k) Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(l) Stock Based Compensation**

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Substantially all stock-based compensation reflected in reported net income (loss) relates to restricted stock award grants to members of the Company's Board of Directors, as all employee stock options granted under the Company's stock option plans had an exercise price equal to the market value of the underlying common stock on the grant date.

SFAS No. 123, "Accounting for Stock-Based Compensation," (SFAS 123) established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." The following table illustrates the effect on net income (loss) and net income (loss) per common share if the company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

<i>Thousands (except per share amounts)</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net income (loss), as reported	5,193	(4,450)	(24,360)
Add: stock-based employee compensation expense included in reported net income (loss), net of related tax effects	58	167	62
Deduct: stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	<u>(1,714)</u>	<u>(3,341)</u>	<u>(4,375)</u>
Pro forma net income (loss)	<u>3,537</u>	<u>(7,624)</u>	<u>(28,673)</u>
Net income (loss) per common share:			
As reported	<u>0.34</u>	<u>(0.30)</u>	<u>(1.67)</u>
Pro forma	<u>0.23</u>	<u>(0.52)</u>	<u>(1.97)</u>
Net income (loss) per common share – assuming dilution:			
As reported	<u>0.34</u>	<u>(0.30)</u>	<u>(1.67)</u>
Pro forma	<u>0.23</u>	<u>(0.52)</u>	<u>(1.97)</u>

The per share weighted average fair value of stock options, granted at a price equal to the market value of the underlying common stock on the grant date was \$5.89, \$4.23, and \$6.37 during the fiscal years ended June 30, 2004, 2003, and 2002, respectively.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The fair value was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	<b>2004</b>	<b>2003</b>	<b>2002</b>
Expected life (years)	2.72	2.40	2.95
Risk free interest rate	2.28%	2.39%	3.74%
Volatility	76.26%	77.93%	72.08%
Dividend yield	—	—	—

**(m) Comprehensive Income (Loss)**

Comprehensive income (loss) represents net income (loss) for the period adjusted for non-owner changes in stockholders' equity in the consolidated financial statements. Cumulative comprehensive income (loss) in the Consolidated Statements of Changes in Stockholders' Equity consists of foreign currency translation adjustments.

**(n) Currency Translation**

For foreign operations that prepare financial statements in functional currencies other than the U.S. dollar, the Company translates the assets and liabilities at the exchange rates in effect at the end of the period and the statement of operations balances using average exchange rates from throughout the period. Cumulative translation adjustments are presented as a separate component of accumulated other comprehensive income (loss) within stockholders' equity. Gains or losses from transactions denominated in non-functional currencies are recognized in the statement of operations based on changes in the exchange rates during the period the transactions remain outstanding.

**2) Business Acquisition**

There were no business acquisitions during the year ended June 30, 2004. SBS completed the acquisition described below during the fiscal year ended June 30, 2003. The acquisition was accounted for using the purchase method of accounting, and the results of operations of the acquired companies have been combined with SBS' since the date of the acquisition. The purchase price has been allocated to the underlying assets acquired and liabilities assumed based on their estimated fair values with goodwill, if any, representing the excess of the purchase price over the fair value of the net assets acquired.

On June 30, 2003, SBS acquired 100 percent of the outstanding common stock of Avvida Holdings Corp. and its wholly-owned subsidiary, Avvida Systems Inc. (Avvida), located in Waterloo, Canada. Avvida provides image processing solutions to customers serving a wide variety of applications. Avvida's focus is emerging programmable logic, including fully programmable gateway array (FPGA) technology utilized in high performance video, image and data processing solutions. The Company plans to incorporate FPGA technology into existing and future products of SBS.

The aggregate purchase price of \$6.2 million, including acquisition costs of \$0.6 million, was paid in cash and shares of SBS common stock valued at \$3,574,020. The value of the 386,940 shares of SBS common stock was determined based on the average market price of SBS' common shares over the two-day period before and after the terms of the acquisition were agreed to and announced.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	\$ 437
Property and equipment	388
Intangible assets	2,237
Goodwill	3,496
Deferred income taxes	280
Total assets acquired	<u>6,838</u>
Current liabilities	(473)
Notes payable	(148)
Total liabilities assumed	<u>(621)</u>
Net assets acquired	<u>\$ 6,217</u>

In conjunction with the purchase price allocation, the estimated fair value of identifiable intangible assets, specifically, a core technology asset valued at \$970,000 and a covenant not-to-compete valued at \$1.2 million, were based on an assessment of their fair value determined by management and goodwill of approximately \$3.5 million was recorded which is not deductible for tax purposes. During the year ended June 30, 2004, the Company received an income tax refund that exceeded the amount recorded at the acquisition by \$104,000 which was recorded as a reduction to goodwill. The identifiable intangible assets are being amortized over a period of 5 years based on the estimated economic useful life of the core technology asset and the contractual period of the covenant.

### 3) Receivables

Receivables, net consisted of the following:

	<i>Thousands</i>	
	<b>June 30,</b>	<b>2004</b>
Accounts receivable	\$ 24,335	\$ 24,000
Allowance for doubtful accounts:		
Beginning balance	(836)	(1,373)
Provision for bad debts	(81)	(458)
Accounts written off and foreign currency translation adjustments	358	995
Ending balance	<u>(559)</u>	<u>(836)</u>
Accounts receivable, net	<u>\$ 23,776</u>	<u>\$ 23,164</u>

### 4) Inventories

Inventories consisted of the following:

	<i>Thousands</i>	
	<b>June 30,</b>	<b>2004</b>
Raw materials	\$ 11,444	\$ 8,793
Work in process	6,596	5,414
Finished goods	8,209	2,609
	<u>\$ 26,249</u>	<u>\$ 16,816</u>

The Company's policy is to dispose of obsolete inventory as soon as practicable after such inventory has been identified as having no value. During fiscal 2004, the sale of inventory written down to zero cost amounted to approximately \$0.8 million, increasing gross margin as a percentage of sales by 0.6%. During fiscal 2003, we sold approximately \$1.0 million of inventory written down to zero cost, increasing gross margin as a percentage of sales by 0.9%.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

SBS recorded a \$12.4 million inventory write-down during the second quarter of fiscal 2002, and a \$2.7 million inventory write-down during the fourth quarter of fiscal 2002. The second quarter write-down consisted of inventory associated with programs that are not anticipated to come back to their previous forecasts, inventory associated with SBS' decision to exit our legacy PCI chassis product line, and inventory associated with SBS products that were no longer marketed. Additionally, the implementation of a new inventory management methodology associated with the consolidation of SBS' manufacturing operations resulted in a reduction in required inventory levels. The fourth quarter write-down was primarily due to customer order cancellations and reduced demand for certain communications and enterprise products noted during the fourth quarter.

**5) Property and Equipment**

Property and equipment, net consisted of the following:

<i>Thousands</i>	<b>Estimated useful life</b>	<b>June 30,</b>	
		<b>2004</b>	<b>2003</b>
Computers	3 – 5 yrs	\$ 5,848	\$ 5,392
Purchased software	3 – 5 yrs	8,682	7,925
Furniture and equipment	3 – 10 yrs	7,478	6,001
Leasehold improvements	2 – 7 yrs	<u>3,488</u>	<u>3,278</u>
		25,496	22,596
Less accumulated depreciation and amortization		(17,517)	(14,134)
		\$ 7,979	\$ 8,462

During the quarter ended June 30, 2003, the Company recorded an impairment charge of approximately \$841,000, included in the caption "Employee severance and consolidation costs" in the accompanying financial statements, related to certain leasehold improvements in connection with the announcement of the Company's consolidation of the communications operations resulting in the closure of its Carlsbad, California facility. The impairment charge was recognized based on the amount by which the carrying amount of the assets exceeded the fair value of the assets as determined on the date of announcement in accordance with SFAS 144.

**6) Goodwill and Intangible Assets**

Effective July 1, 2002, SBS adopted SFAS 142 and no longer amortizes goodwill. As of the date of adoption, SBS had unamortized goodwill of approximately \$20.5 million subject to the transition provisions of SFAS 142, which included approximately \$434,000 for the net book value of acquired assembled workforce intangibles, as these assets did not meet the criteria for recognition apart from goodwill.

The Company completed step 1 of the required transitional goodwill impairment analysis in accordance with SFAS 142 prior to December 31, 2002 and an indication of potential impairment was determined for two reporting units, the Commercial reporting unit and the Communications and Enterprise reporting unit (both components of the Americas Group segment). The Company completed step 2 of the required transitional analysis during the quarter ended June 30, 2003 and the results indicated the carrying value of goodwill for both reporting units was greater than the implied fair value of the goodwill determined in accordance with SFAS 142. As a result, the Company recorded a transitional impairment charge of approximately \$9.5 million (\$6.1 million net of tax) which has been reflected as a cumulative effect of a change in accounting principle in the year ended June 30, 2003 in the accompanying statements of operations.

On April 1, 2004 and 2003, the Company completed step 1 of the required annual goodwill impairment analysis for the fiscal years ended June 30, 2004 and 2003, respectively, and the estimated fair value of goodwill was determined to be in excess of its carrying value indicating the underlying goodwill was not impaired at that date.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Changes in the carrying amount of goodwill for the years ended June 30, 2004 and 2003 are as follows:

<b>Total Goodwill by Operating Segment</b>			
<i>Thousands</i>	<b>Americas Group</b>	<b>Europe Group</b>	<b>Total</b>
Balance at June 30, 2002	\$ 9,470	10,998	20,468
Transitional impairment charge	(9,470)	–	(9,470)
Acquisition of Avvida	3,496	–	3,496
Foreign currency translation adjustments	–	1,630	1,630
Balance at June 30, 2003	\$ 3,496	12,628	16,124
Foreign currency translation adjustments	24	690	714
Income tax refund in excess of amount recorded at acquisition	(104)	–	(104)
Balance at June 30, 2004	<u>\$ 3,416</u>	<u>13,318</u>	<u>16,734</u>

The following table presents the impact of the adoption of SFAS 142 on reported income (loss) before the cumulative effect of a change in accounting principle and net income (loss) per applicable common share before the cumulative effect of a change in accounting principle had SFAS 142 been in effect in fiscal 2002:

<i>Thousands except per share amounts</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Reported income (loss) before cumulative effect of change in accounting principle	\$ 5,193	1,608	(24,360)
Adjustments:			
Goodwill amortization	–	–	4,448
Workforce amortization	–	–	75
Income tax effect	–	–	(1,741)
Net adjustments	–	–	2,782
Adjusted income (loss) before cumulative effect of change in accounting principle	<u>\$ 5,193</u>	<u>1,608</u>	<u>(21,578)</u>
Income (loss) per common share before cumulative effect of change in accounting principle:			
Reported	\$ 0.34	0.11	(1.67)
Adjusted	0.34	0.11	(1.48)
Income (loss) per share – assuming dilution before cumulative effect of change in accounting principle:			
Reported	\$ 0.34	0.11	(1.67)
Adjusted	0.34	0.11	(1.48)

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following table discloses information regarding the carrying amounts and associated accumulated amortization for intangible assets subject to amortization.

<i>Thousands</i>	<b>Amortized Intangible Assets</b>			
	<b>Estimated useful life</b>	<b>Gross carrying amount</b>	<b>Accumulated amortization</b>	<b>Net carrying amount</b>
<u><b>As of June 30, 2004</b></u>				
Core-developed technology	2 – 7 yrs	\$ 9,724	6,767	2,957
License agreements	2 – 5 yrs	2,425	1,781	644
Covenant not-to-compete	3 – 5 yrs	2,852	1,890	962
Other intangibles	8 – 17 yrs	368	167	201
Total		<u>\$ 15,369</u>	<u>10,605</u>	<u>4,764</u>
<u><b>As of June 30, 2003</b></u>				
Core-developed technology		\$ 9,723	5,679	4,044
License agreements		2,561	1,424	1,137
Covenant not-to-compete		2,842	1,365	1,477
Other intangibles		368	120	248
Total		<u>\$ 15,494</u>	<u>8,588</u>	<u>6,906</u>

During the fourth quarter of fiscal 2002, due to order cancellations and a continued decline in sales and bookings, SBS recorded a \$10.3 million write-down of the core-developed technology and related goodwill associated with the acquisition of SDL Communications, Inc. in April 2000. This write-down was based on SBS' projection of undiscounted future operating cash flows over the remaining useful lives of the core-technology asset and related goodwill, which indicated that these cash flows were not sufficient to recover the carrying amounts of the assets. As such, impairment charges were recorded to the extent that the carrying amount of the assets exceeded fair value. Additionally, on December 26, 2001, the SBS Board of Directors approved SBS' plan to exit our legacy PCI chassis product line. This product line was associated with SBS' acquisition of SBS Technologies, Inc. Industrial Computers (formerly Micro Alliance) in November 1997. In conjunction with the acquisition, SBS recorded approximately \$4.5 million of goodwill, of which \$2.7 million was unamortized at December 26, 2001. Based on SBS' decision to exit the PCI Chassis product line, the remaining unamortized goodwill was determined to be impaired and was written off in the quarter ended December 31, 2001, as the fair value of projected future cash flows was zero.

The following table summarizes estimated future amortization expense.

<b>Estimated amortization expense:</b>	<i>Thousands</i>
For the fiscal years ending:	
June 30, 2005	\$ 1,736
June 30, 2006	1,311
June 30, 2007	1,183
June 30, 2008	493
June 30, 2009	5
Thereafter	36
	<u>4,764</u>

## 7) Product Warranty Liability

The Company's customers receive a warranty, generally for a period of two years, upon purchase of products. The Company accrues estimated costs to repair or replace potentially defective products when products are shipped and revenue is recognized. Estimated warranty costs are based upon prior actual warranty costs for substantially similar transactions.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following table presents the activity in the Company's product warranty liability for the years ended June 30, 2004 and 2003.

<i>Thousands</i>	<b>Years ended June 30,</b>	
	<b>2004</b>	<b>2003</b>
Balance at beginning of period	\$ 548	567
Estimated warranty costs for product sales	917	554
Adjustments to settle warranty activity	<u>(866)</u>	<u>(573)</u>
Balance at end of period	\$ 599	548

#### **8) Income Taxes**

Income (loss) from continuing operations before income taxes and cumulative effect of change in accounting principle is comprised of the following:

<i>Thousands</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
U.S.	\$ 1,663	(2,142)	(38,833)
Foreign	<u>5,755</u>	<u>4,534</u>	<u>1,023</u>
	\$ 7,418	2,392	(37,810)

Total income taxes for the years ended June 30, 2004, 2003 and 2002 were allocated as follows:

<i>Thousands</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Income from continuing operations	\$ 2,225	784	(13,450)
Cumulative effect of change in accounting principle	<u>—</u>	<u>(3,412)</u>	<u>—</u>
	\$ 2,225	(2,628)	(13,450)

Income tax expense (benefit) from continuing operations is comprised of the following:

<i>Thousands</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Current:			
U.S. Federal	\$ —	(6,793)	(3,911)
State	230	107	32
Foreign	2,168	1,271	722
Deferred:			
U.S. Federal	757	5,345	(8,953)
State	(508)	506	(1,540)
Foreign	<u>(422)</u>	<u>348</u>	<u>200</u>
	\$ 2,225	784	(13,450)

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Income tax expense (benefit) from continuing operations was provided for at effective rates of 30.0, 32.8, and 35.6 percent in 2004, 2003, and 2002, respectively. Actual tax expense (benefit) differ from the “expected” income taxes (computed by applying the statutory U.S. Federal tax rate to income before income taxes) as follows:

Thousands	Years ended June 30,		
	2004	2003	2002
Computed “expected” tax expense (benefit)	\$ 2,596	837	(13,234)
State income taxes, net of federal benefit and impact of valuation allowance	(181)	398	(980)
Non-deductible goodwill	—	—	1,599
Foreign operations, net	(116)	600	433
Benefit from foreign sales	(131)	(105)	(646)
Research and experimental tax credits	23	(76)	(648)
Change in federal valuation allowance	—	(789)	—
Other	34	(81)	26
	\$ 2,225	784	(13,450)

The significant components of deferred income tax assets and liabilities are as follows:

Thousands	As of June 30,	
	2004	2003
Deferred tax assets:		
Operating loss and tax credit carryforwards	\$ 7,571	2,622
Amortization	5,584	7,352
Foreign tax credits	2,747	1,557
Inventory	1,376	1,751
Accrued expenses and reserves	1,351	1,604
Other	342	166
	18,971	15,052
Valuation allowance for State operating loss and tax credit carryforwards	1,336	—
Total deferred tax assets	\$ 17,635	15,052
Deferred tax liabilities:		
Foreign dividends	\$ (1,812)	(847)
Occupancy and other expenses	(1,299)	(1,490)
Total deferred tax liabilities	(3,111)	(2,337)
Net deferred tax assets	\$ 14,524	12,715

At June 30, 2004, the Company has net operating loss carryforwards for U.S. Federal income tax purposes of \$7.1 million which are available to offset future U.S. Federal taxable income, if any, through 2024. At June 30, 2004, the Company has general business credit carryforwards for U.S. Federal income tax purposes of approximately \$0.9 million which are available to offset future U.S. Federal tax payments, if any, through 2024. At June 30, 2004, the Company has net operating loss carryforwards for U.S. State income tax purposes, the tax effect of which, after reduction by the associated valuation allowance, is approximately \$1.6 million, which are available to offset future State taxable income, if any, through 2009. The valuation allowance, which increased approximately \$1.3 million during the year ended June 30, 2004, applies to certain U.S. State operating loss and tax credit carryforwards that, in the opinion of management, may expire unused due to uncertainty regarding future taxable income.

As of June 30, 2004, SBS has foreign tax credit carryforwards of approximately \$2.7 million, which are available to offset future U.S. Federal tax liabilities from foreign source income, if any, through 2009. Excess foreign tax credits may be carried back two years and forward five years. During the quarter ended June 30, 2003, in conjunction with the execution of certain tax planning strategies management believed that it was more likely than not that the

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Company would realize the benefits of the foreign tax credit carryforwards. Accordingly, during the year ended June 30, 2003, the Company released the federal valuation allowance of approximately \$0.8 million established in prior periods associated with foreign tax credit carryforwards. In addition, due to the consideration of the repatriation of undistributed foreign earnings, to the extent necessary to utilize excess foreign tax credits, as a source of foreign income in future periods, management established a deferred tax liability of approximately \$1.8 million and \$0.8 million as of June 30, 2004 and 2003, respectively.

At June 30, 2004, the Company has foreign net operating loss and tax credit carryforwards of approximately \$3.9 million which are available to offset future taxable income, some of which are scheduled to begin to expire in 2013, and others that have an indefinite carryforward period.

In assessing the realizability of the remaining deferred tax assets, management considered projected future taxable income and tax planning strategies. Based on SBS' historical taxable transactions, the timing of the reversal of existing temporary differences, and the evaluation of tax planning strategies, management believes it is more likely than not that SBS' future taxable income will be sufficient to realize the benefit of the remaining deferred tax assets existing at June 30, 2004.

SBS generally does not record deferred income taxes on the undistributed earnings of its foreign subsidiaries in accordance with the indefinite reversal criterion in APB Opinion No. 23, "Accounting for Income Taxes – Special Areas", because the Company currently does not expect those unremitted earnings to reverse and become taxable in the foreseeable future. At June 30, 2004, the undistributed earnings of foreign subsidiaries amounted to approximately \$26.4 million. Upon distribution of these earnings, SBS may be subject to U.S. income taxes and foreign withholding taxes. It is not practical, however, to estimate the amount of taxes that may be payable on the eventual remittance of these earnings.

## 9) Earnings Per Share

Net income (loss) per common share is based on weighted average shares outstanding. Net income (loss) per common share – assuming dilution includes the dilutive effects of potential common shares outstanding during the period.

	<i>Thousands (except per share amounts)</i>		
	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Income (loss) before cumulative effect of change in accounting principle	\$ 5,193	1,608	(24,360)
Cumulative effect of change in accounting principle	—	(6,058)	—
<b>Net income (loss)</b>	<b>\$ 5,193</b>	<b>(4,450)</b>	<b>(24,360)</b>
<b>Net income (loss) per common share</b>			
Weighted-average common shares outstanding used in earnings per share computations	15,146	14,605	14,559
Income (loss) before cumulative effect of change in accounting principle	\$ 0.34	0.11	(1.67)
Cumulative effect of change in accounting principle	—	(0.41)	—
<b>Net income (loss)</b>	<b>\$ 0.34</b>	<b>(0.30)</b>	<b>(1.67)</b>

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

<i>Thousands (except per share amounts)</i>	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Net income (loss) per common share – assuming dilution</b>			
Weighted-average common shares outstanding used in earnings per share computations	15,477	14,630	14,559
Income (loss) before cumulative effect of change in accounting principle	\$ 0.34	0.11	(1.67)
Cumulative effect of change in accounting principle	—	(0.41)	—
Net income (loss)	<u>\$ 0.34</u>	<u>(0.30)</u>	<u>(1.67)</u>
<b>Shares used in net income (loss) per share computations</b>			
Average outstanding common shares	15,146	14,605	14,559
Incremental shares from assumed conversions – potential common shares	331	25	—
Shares used in net income (loss) per common share – assuming dilution	<u>15,477</u>	<u>14,630</u>	<u>14,559</u>

Due to the reported net loss for the year ended June 30, 2002, 190,757 potential common shares were not included in the computation of net loss per common share – assuming dilution because the effect would be anti-dilutive. For the years ended June 30, 2004, 2003, and 2002, options to purchase 1,551,073, 3,243,859, and 2,381,237 shares of common stock, respectively, were outstanding but were not included in the computation of net income per common share – assuming dilution, because the options' exercise price was greater than the average market price of the common shares.

#### **10) Leases**

SBS leases its main facilities in Albuquerque, New Mexico; St. Paul, Minnesota; Raleigh, North Carolina; Mansfield, Massachusetts; Newark, California; Waterloo, Ontario, Canada; Augsburg and Mindelheim, Germany; and a sales and technical support office in Shenzhen, China under noncancelable operating leases which expire at various dates through fiscal 2008. SBS also leases equipment under noncancelable operating leases which expire at various dates through fiscal 2009.

On June 12, 2003, the Company announced the closure of its Carlsbad, California facility and the consolidation of its manufacturing operations into the Company's St. Paul, Minnesota facility, centralizing all manufacturing in the United States to one facility (see note 16). As a result, the Company recorded a lease termination charge associated with the former Carlsbad, California facility that represents the estimated fair value of the remaining future lease payments and related obligations, net of sublease income, over the remaining term of the lease. The remaining accrued severance and consolidation costs at June 30, 2004 represent primarily lease obligations expected to be paid monthly through April 2006. Accordingly, the future minimum lease payments for the Carlsbad lease are excluded from the minimum lease payments reflected below.

Effective in July 2004, we executed a lease for a one-story build-to-suit facility to be located in Albuquerque, New Mexico. The term of the lease will commence upon the later of substantial completion of construction or May 1, 2005 and will run for a period of approximately 122 months after the commencement of the lease term. The lease payments for this new facility are included in the future minimum lease payments reflected below.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

The following is a five-year schedule of future minimum lease payments:

<b><u>Year ending</u></b>	<b><u>Buildings Lease Payments</u></b>	<b><u>Equipment Lease Payments</u></b>	<b><u>Total</u></b>
(dollars in thousands)			
June 30, 2005	\$ 2,168	190	2,358
June 30, 2006	1,565	102	1,667
June 30, 2007	1,037	68	1,105
June 30, 2008	726	2	728
June 30, 2009	685	1	686
	\$ 6,181	363	6,544

Total rental expense for operating leases for the years ended June 30, 2004, 2003, and 2002, was approximately \$3.1 million, \$3.6 million, and \$3.5 million, respectively.

**11) Stock Option Plans**

**(a) Incentive Stock Option Plans**

SBS has Incentive Stock Option Plans (the 1996 Plan and the 1997 Plan) whereby a total of 1,200,000 shares of its common stock are reserved for discretionary grant of options by the Board to officers and employees. The plans terminate ten years after inception, in 2005 and 2006. The options are intended to qualify as “incentive stock options” within the meaning of Section 422A of the Internal Revenue Code (the “Code”). The plans generally permit options to be granted (i) only to employees or officers and not to directors as such; (ii) for a period of up to ten years; and (iii) at prices not less than fair market value of the underlying common stock at the date of grant. Under the Code, holders of more than 10 percent of SBS’ stock cannot be granted options with a duration of more than five years or exercisable at a price less than 110 percent of the fair market value of the underlying common stock on the date of grant. Options granted under the plans may be exercised as provided by the administering committee or Board of Directors of SBS. All of these options are exercisable at the quoted market value of SBS’ common stock in effect on the respective dates of the grants.

**(b) 1993 Director and Officer Stock Option Plan**

SBS has a 1993 Director and Officer Stock Option Plan whereby a total of 5% of the number of shares of its common stock outstanding at the first day of each fiscal year plus shares not awarded in prior years and underlying expired or terminated options are reserved for grant of options to all Directors of SBS who are not employees and all Executive Officers of SBS. Directors who are not employees of SBS receive automatic grants upon appointment to the Board of Directors and annually for service as a Director. Executive Officers receive grants at the discretion of the Board of Directors. All options are granted at a price equal to fair market value of the underlying common stock on the date of grant. The Directors’ options become exercisable one year from the date of grant and terminate twelve months from the date the optionee ceases to be a member of the Board of Directors or in five years, whichever occurs first.

**(c) 1996 Employee Stock Purchase Plan**

The 1996 Employee Stock Purchase Plan was adopted by the Board of Directors on January 21, 1996 and was subsequently approved at the November 1996 Annual Shareholders’ Meeting. Options are eligible to be exercised beginning 18 months after the date of grant for a period of nine months, at which time they will expire. The plan, as amended, provided for the grant of options to eligible employees through January 21, 2003. As a result, there are no more shares available for grant in this plan as of June 30, 2004.

**(d) 1998 Long-Term Equity Incentive Plan**

The 1998 Long-Term Equity Incentive Plan was adopted by the Board of Directors on September 15, 1997 and subsequently approved at the December 1997 reconvened Annual Shareholders’ Meeting. All full-time employees of

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

SBS and its subsidiaries and all non-employee Directors of SBS are eligible to participate in the plan, except that no person owning, directly or indirectly, more than 15% of the total combined voting power of all classes of stock shall be eligible to participate. The plan provides for the grant of any or all of the following types of awards: (i) stock options, including incentive stock options; (ii) stock appreciation rights; (iii) restricted stock; (iv) performance shares and units; and (v) other stock-based awards. The maximum number of shares of common stock that shall be available for grant of awards under the plan shall not exceed 3,000,000, subject to adjustment in accordance with the provisions of the plan. The exercise price of each option granted under (i) is determined by the Board of Directors but cannot be less than 100% of the fair market value of the underlying common stock on the date of grant. The exercise price of each option granted under (v) is determined by the Board of Directors and can be less than the fair market value of the underlying common stock on the date of grant. The term of these options cannot exceed ten years from grant date. The plan expires in January 2008.

**(e) 2000 Long-Term Equity Incentive Plan**

The 2000 Long-Term Equity Incentive Plan was adopted by the Board of Directors on August 31, 2000 and subsequently approved at the December 2000 reconvened Annual Shareholders' Meeting. Any employee of SBS or its subsidiaries, and any consultants, directors, or other persons providing services to SBS or its subsidiaries are eligible to participate in the plan. The plan provides for the grant of nonqualified stock options and a limited number of grants of restricted stock. The number of shares of stock available for award under the plan during any fiscal year of SBS is equal to ten percent of the adjusted average of the outstanding stock, as that number is determined by SBS to calculate net income per common share – assuming dilution for the preceding fiscal year, reduced by any shares of stock under the plan subject to unexercised options and any shares of stock under the plan subject to restrictions. The exercise price of each option granted shall be the fair market value of the underlying common stock on the date of grant unless otherwise specified by the Board at the time of grant. If options are awarded in exchange for previously earned cash compensation, or in connection with an acquisition, merger, combination or other similar event involving SBS, or in substitution or replacement for options granted to employees by the other entities, the Board has the authority to establish an exercise price that is less than 100% of the fair market value of the underlying common stock on the date of grant. The term of these options cannot exceed ten years from grant date. The plan expires in July 2010.

Information regarding SBS' stock option plans is summarized in the table below:

	<b>ALL ISOPs</b>	<b>1993 D&amp;O</b>	<b>1996 ESPP</b>	<b>1998 LT Plan</b>	<b>2000 LT Plan</b>	<b>Total</b>
Outstanding at June 30, 2001	389,572	518,883	185,102	1,569,079	674,500	3,337,136
Granted	—	404,479	188,650	25,000	482,337	1,100,466
Exercised	41,000	10,000	—	128,129	—	179,129
Cancelled	—	256,883	147,552	230,695	268,988	904,118
Outstanding at June 30, 2002	348,572	656,479	226,200	1,235,255	887,849	3,354,355
Granted	—	159,000	159,050	58,105	250,100	626,255
Exercised	566	—	—	4,994	—	5,560
Cancelled	—	127,500	110,900	163,375	219,966	621,741
Outstanding at June 30, 2003	348,006	687,979	274,350	1,124,991	917,983	3,353,309
Granted	—	30,000	—	72,684	472,300	574,984
Exercised	53,000	96,000	47,250	165,094	135,081	496,425
Cancelled	45,004	36,979	107,450	129,460	160,470	479,363
Outstanding at June 30, 2004	250,002	585,000	119,650	903,121	1,094,732	2,952,505

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

	<b>ALL ISOPs</b>	<b>1993 D&amp;O</b>	<b>1996 ESPP</b>	<b>1998 LT Plan</b>	<b>2000 LT Plan</b>	<b>Total</b>
Exercisable at June 30, 2002	315,234	252,000	74,650	835,750	279,079	1,756,713
Exercisable at June 30, 2003	331,336	372,661	124,350	976,138	542,892	2,347,377
Exercisable at June 30, 2004	250,000	356,000	119,650	767,536	537,465	2,030,651
Available for grant at June 30, 2004	137,000	1,405,824	—	798,893	452,921	2,794,638

Weighted average option exercise price information follows:

	<b>Years ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Outstanding at July 1	\$ 15.08	16.60	17.78
Granted at market during the year	12.23	9.53	13.20
Exercised during the year	11.37	2.41	8.68
Cancelled during the year	16.57	17.84	18.58
Outstanding at June 30	14.91	15.08	16.60
Exercisable at June 30	16.40	16.68	17.00

Significant option groups outstanding and exercisable at June 30, 2004 and related weighted average price and life information follows:

<b>Range of Exercise Prices</b>	<b>Number <u>Outstanding</u></b>	<b>Weighted Average Remaining Contractual <u>Life</u></b>	<b>Weighted Average Exercise <u>Price</u></b>	<b>Number <u>Exercisable</u></b>	<b>Weighted Average Exercise <u>Price</u></b>
\$ 5.44 – \$ 9.91	678,417	6.65	\$ 9.00	267,347	\$ 8.64
\$10.05 – \$12.31	589,782	7.42	11.65	403,632	11.64
\$12.69 – \$14.76	669,006	6.51	14.01	400,372	13.69
\$14.81 – \$18.22	616,800	3.96	16.26	560,800	16.37
\$19.58 – \$36.13	398,500	6.20	29.20	398,500	29.20
<b>\$ 5.44 – \$36.13</b>	<b>2,952,505</b>	<b>6.15</b>	<b>\$ 14.91</b>	<b>2,030,651</b>	<b>\$ 16.40</b>

## **12) Retirement Plan**

SBS maintains a retirement plan under Section 401(k) of the Code for all U.S. employees of SBS. The plan provides for employees to selectively defer a percentage of their wages, which SBS matches at a predetermined rate not to exceed 4 percent of the employee's wages. The plan also provides for additional contributions at the discretion of the Board of Directors. SBS' contributions to the plan during the years ended June 30, 2004, 2003, and 2002, were approximately \$0.9 million, \$1.0 million, and \$1.1 million, respectively.

## **13) Segment Financial Data**

As a result of changes in management responsibility, the Company's desire to enhance its regional-based sales and service to the Company's European customers and the June 2003 acquisition of SBS Canada (formerly Avvida Systems), the Company changed its reportable segments to a structure based on geographic markets. This change has enabled

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

management to focus on regional market development, alignment of sales channels with customers' product needs, and enhancement of customer service and satisfaction.

The Company is engaged in the design, research, development, integration and production of embedded computer products and we operate worldwide through two operating segments: the Americas Group and the Europe Group. Both the Americas Group and the Europe Group offer our complete portfolio of embedded computer products to customers in the government, commercial and communications end markets. Each segment has management who report directly to the Company's Chief Executive Officer and its own sales and distribution channels. The Americas Group consists of the Company's operations based in the United States and Canada including the engineering, test, and assembly activities in Albuquerque, New Mexico; Mansfield, Massachusetts; Newark, California; Raleigh, North Carolina; St. Paul, Minnesota; and Waterloo, Ontario, Canada; the manufacturing operations located in St. Paul, Minnesota; and the sales and support activities based in Shenzhen, China. The Europe Group consists of the Company's operations based in Germany which include the engineering, test, assembly, and manufacturing activities located in Augsburg and Mindelheim, Germany.

SBS measures the results of operations for segments (segment profit (loss)) based on income (loss) before income taxes and the cumulative effect of change in accounting principle and prior to (a) the allocation of corporate overhead expenses other than marketing costs, (b) substantially all amortization associated with acquisitions and (c) interest and other income from our U.S. operations. The accounting policies used to measure segment profit (loss) are the same as those referred to in Note 1, *Summary of Significant Accounting Policies*. Reportable segments for all periods presented have been reclassified to conform to the current segment reporting structure.

Thousands	<b>Americas Group</b>	<b>Europe Group</b>	<b>Corporate &amp; Unallocated (1)</b>	<b>Total</b>
<b>Years ended June 30:</b>				
Gross Sales	<b>2004</b>	103,202	44,505	–
Inter-segment sales		(6,136)	(7,697)	–
Sales to external customers		97,066	36,808	–
				133,874
Gross Sales	<b>2003</b>	97,459	26,734	–
Inter-segment sales		(3,191)	(5,481)	–
Sales to external customers		94,268	21,253	–
				115,521
Gross Sales	<b>2002</b>	106,901	16,767	–
Inter-segment sales		(613)	(4,199)	–
Sales to external customers		106,288	12,568	–
				118,856
Interest and other income, net	<b>2004</b>	–	134	500
	<b>2003</b>	–	109	325
	<b>2002</b>	382	67	182
				634
Depreciation and amortization	<b>2004</b>	2,437	343	3,260
	<b>2003</b>	2,768	214	2,998
	<b>2002</b>	2,575	169	8,567
				6,040
Segment profit (income (loss) before taxes)	<b>2004</b>	12,864	7,540	(12,986)
	<b>2003</b>	10,073	5,138	(12,819)
	<b>2002</b>	(5,976)	3,287	(35,121)
				2,392
				(37,810)
<b>As of June 30:</b>				
Total Assets	<b>2004</b>	39,640	26,531	78,965
	<b>2003</b>	35,798	17,540	75,272
				128,610

- (1) The corporate and unallocated column includes amounts for corporate items. With regard to results of operations, corporate and unallocated includes corporate overhead expenses other than corporate marketing costs, interest and other income, net from our U.S. operations, and substantially all amortization associated with acquisitions. Corporate assets primarily include cash and cash equivalents from our U.S. operations, deferred and current income tax assets, goodwill and intangible assets.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**14) Geographic Areas and Major Customers**

Geographic information for sales to external customers (attributed based on the location of the product shipment) and long-lived assets by country of domicile are as follows:

<i>Thousands</i>	<u>United States</u>	<u>Germany</u>	<u>Canada</u>	<u>Total</u>
<b>Years ended June 30:</b>				
Sales to external customers	<b>2004</b> \$ 95,966	36,808	1,100	\$ 133,874
	<b>2003</b> 94,268	21,253	—	115,521
	<b>2002</b> 106,288	12,568	—	118,856
<b>As of June 30:</b>				
Long-lived assets, net	<b>2004</b> \$ 6,028	1,516	435	\$ 7,979
	<b>2003</b> 7,473	601	388	8,462

Geographic information for sales to external customers attributed based on the location of the customer are as follows:

<i>(Dollars in thousands)</i>	<b>Years ended June 30,</b>					
	<b>2004</b>		<b>2003</b>		<b>2002</b>	
	<u>Sales</u>	<u>%</u>	<u>Sales</u>	<u>%</u>	<u>Sales</u>	<u>%</u>
United States	\$ 91,636	68.4%	\$ 83,298	72.1%	88,499	74.5%
Sweden	11,930	8.9%	2,002	1.7%	3,250	2.7%
Germany	7,205	5.4%	6,533	5.7%	5,139	4.3%
Japan	5,231	3.9%	3,835	3.3%	3,066	2.6%
France	4,054	3.0%	2,964	2.6%	3,636	3.1%
Denmark	2,665	2.0%	3,019	2.6%	659	0.6%
United Kingdom	2,289	1.7%	3,107	2.7%	1,640	1.4%
Canada	1,046	0.8%	1,546	1.3%	3,494	2.9%
Korea	963	0.7%	1,167	1.0%	1,240	1.0%
Hong Kong	769	0.6%	812	0.7%	284	0.2%
All others	6,086	4.6%	7,238	6.3%	7,949	6.7%
	<b>\$ 133,874</b>	<b>100%</b>	<b>\$ 115,521</b>	<b>100%</b>	<b>\$ 118,856</b>	<b>100%</b>

In fiscal 2004, sales to one customer represented approximately 10% of SBS' sales (\$13.2 million from the Americas Group), sales to another customer represented approximately 8% of SBS' sales (\$10.3 million from the Europe Group) and no other customer exceeded 5% of SBS' sales. In fiscal 2003 and 2002, no single customer, or group of entities known to be under common control, exceeded 10% of SBS' sales.

**15) Related Party Transactions**

Effective March 9, 2001, Grahame E. Rance was appointed to the positions of President and Chief Executive Officer of SBS and member of the Board of Directors. Mr. Rance succeeded Christopher J. Amenson, who remained as Chairman of the Board of Directors of SBS until November 8, 2001, at which time Mr. Rance was appointed as Chairman. As part of his compensation package, Mr. Rance received a \$1,893,750 interest free loan from SBS, paid in cash on April 4, 2001. Forgiveness of the loan was to occur ratably over six annual anniversaries of Mr. Rance's employment with SBS. Additionally, Mr. Rance received a \$570,000 interest free loan from SBS that was repaid upon the sale of his former home during the quarter ended December 31, 2001.

On April 26, 2002, at its regularly scheduled Board meeting, Christopher J. Amenson was elected Chairman of the Board of Directors and Chief Executive Officer and David H. Greig was elected President and Chief Operating Officer. Former Chairman and Chief Executive Officer, Grahame E. Rance, resigned to pursue other business opportunities. As part of the Separation Agreement between Mr. Rance and SBS, the unamortized portion of the loan to Mr. Rance of \$1,573,700 was

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

forgiven, Mr. Rance received 8 months base pay, and he returned 30,000 shares of restricted SBS common stock, 5,000 of which were vested and 25,000 of which were unvested. This resulted in severance and other costs of approximately \$2.0 million in the quarter ended June 30, 2002.

**16) Employee Severance and Consolidation Expenses**

On June 12, 2003, the Company announced the closure of its Carlsbad, California facility and the consolidation of its manufacturing operations into the Company's St. Paul, Minnesota facility, centralizing all manufacturing in the United States to one facility. The total employee severance and consolidation costs incurred as a result of the consolidation were approximately \$3.4 million. The total costs include employee severance and related costs recorded over the remaining service period, consolidation costs recorded as incurred, lease termination costs recorded on the cease use date (all in accordance with SFAS 146), and leasehold improvement impairment charges recorded as a result of the announcement in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

The following table summarizes the accounting for the consolidation of the Company's Carlsbad, California facility:

<i>Thousands</i>	<b>Employee severance and related costs</b>	<b>Property and equipment</b>	<b>Lease termination charge</b>	<b>Other costs</b>	<b>Total</b>
<b>Description</b>					
<b>Quarter ended June 30, 2003</b>					
Employee severance and consolidation costs	\$ 290	841	—	—	\$ 1,131
Cash payments	(66)	—	—	—	(66)
Write-offs	—	(841)	—	—	(841)
Accrued at June 30, 2003	\$ 224	—	—	—	\$ 224
<b>Year ended June 30, 2004</b>					
Employee severance and consolidation costs	\$ 470	—	1,400	530	\$ 2,400
Cash payments	(694)	—	(530)	(530)	(1,754)
Accrued at June 30, 2004	\$ —	—	870	—	\$ 870

The lease termination charge, recorded on the cease use date as a result of closure of the Company's Carlsbad, California facility, represents the estimated fair value of the remaining future lease payments and related obligations, net of estimated sublease income, over the term of the lease. The remaining costs represent primarily lease obligations expected to be paid monthly through April 2006.

During the year ended June 30, 2003, due to the continued depressed economic and market conditions impacting the Company's communications customers, on July 22, 2002, SBS notified 19 full and part-time employees at our Madison, Wisconsin engineering design center that their jobs had been eliminated. For the same reasons, on September 30, 2002, SBS notified 22 additional employees that their jobs were being eliminated and 12 other employees were notified that their jobs had been eliminated during the three months ended December 31, 2002. Also, SBS paid lease termination fees of approximately \$186,000 in connection with the closure of certain locations during the three months ended December 31, 2002. As a result, for the year ended June 30, 2003, SBS recorded employee severance and consolidation costs of \$598,000. There are no costs remaining to be paid related to these activities at June 30, 2004.

During the year ended June 30, 2002, based on unfavorable economic and market conditions, facility consolidation actions, and the decision to exit the legacy PCI Chassis product line, SBS reduced its employee base, resulting in elimination of 159 positions in manufacturing, research and development, administration, and sales and marketing. As a result, for the year ended June 30, 2002, employee severance and other termination charges of approximately \$1,253,000 were recorded. As of June 30, 2002, cash payments of \$963,000 had been made, \$21,000 of the original charge was reversed as a result of the decision not to terminate certain originally notified employees, and the remaining \$269,000 was paid during the year ended June 30, 2003.

**SBS TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

**17) Contingencies**

SBS is subject to various claims that arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position, results of operations, or liquidity of SBS.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures****Controls Evaluation and Related CEO and CFO Certifications**

As of the end of the period covered by this Annual Report on Form 10-K, the company evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”)). The controls evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

Attached as Exhibits to this Annual Report on Form 10-K are certifications of the CEO (Exhibit 31.1) and the CFO (Exhibit 31.2), which are required in accordance with Rule 13a-14 of the Exchange Act. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

**Disclosure Controls and Procedures and Internal Control over Financial Reporting**

Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures are also designed to ensure that the information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) are procedures designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

**Limitations on the Effectiveness of Controls**

Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Conclusions**

Based on our controls evaluation (with the participation of our CEO and CFO), as of the end of the period covered by this report, our CEO and CFO have concluded that, subject to the limitations noted above, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There was no change in our internal control over financial reporting during our fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. *Other Information***

None.

**PART III**

Certain information required by Part III is incorporated by reference from SBS' definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for SBS' 2004 Annual Meeting of Shareholders (the "Proxy Statement") pursuant to Regulation 14A.

**Item 10. *Directors and Executive Officers of the Registrant***

The information required by this item is incorporated by reference to SBS' Proxy Statement under the sections entitled "Board of Directors," pertaining to information on directors, and "Compensation of Named Executive Officers," pertaining to information on executive officers.

**Item 11. *Executive Compensation***

The information required by this item is incorporated by reference to SBS' Proxy Statement under the section entitled "Compensation of Named Executive Officers."

**Item 12. *Security Ownership of Certain Beneficial Owners and Management***

The information required by this item is incorporated by reference to SBS' Proxy Statement under the section entitled "Ownership of SBS Common Stock."

**Item 13. *Certain Relationships and Related Transactions***

The information required by this item is incorporated by reference to SBS' Proxy Statement under the section entitled "Reportable Transactions."

**Item 14. *Principal Accounting Fees and Services***

The information required by this item is incorporated by reference to SBS' Proxy Statement under the section entitled "Independent Public Accountants."

## PART IV

### **Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

#### (a) *Financial Statements*

Consolidated Balance Sheets  
Consolidated Statements of Operations  
Consolidated Statements of Changes in Stockholders' Equity  
Consolidated Statements of Cash Flows

#### (b) *Financial Statement Schedules*

Not applicable

#### (c) *Exhibits*

The Exhibits listed on the accompanying Index to Exhibits at the end of this Report are filed as part of, or incorporated by reference into, this Report. Management contracts or compensatory plans or arrangements are indicated in the index by an asterisk (\*).

#### (d) *Reports on Form 8-K during the Fourth Quarter*

1. On April 15, 2004, SBS Technologies, Inc. filed a Form 8-K furnishing information regarding its financial results for the quarter ended March 31, 2004.
2. On April 21, 2004, SBS Technologies, Inc. filed a Form 8-K announcing that at its regularly scheduled meeting the Board of Directors accepted the resignation for personal reasons of Director Louis C. Golm.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SBS TECHNOLOGIES, INC.

Date: September 10, 2004

By: /s/ Clarence W. Peckham  
Clarence W. Peckham  
*Chief Executive Officer*

Date: September 10, 2004

By: /s/ James E. Dixon, Jr.  
James E. Dixon, Jr.  
*Executive Vice President, Chief  
Financial Officer, and Treasurer*

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Clarence W. Peckham, his attorney-in-fact, for such person in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that the said attorney-in-fact may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>SIGNATURE</u>	<u>TITLE</u>	<u>DATE</u>
<u>/s/ Clarence W. Peckham</u> Clarence W. Peckham	Chief Executive Officer and Director	September 10, 2004
<u>/s/ James E. Dixon, Jr.</u> James E. Dixon, Jr.	Executive Vice President, Chief Financial Officer and Treasurer	September 10, 2004
<u>/s/ Christopher J. Amenson</u> Christopher J. Amenson	Chairman of the Board of Directors and Executive Chairman	September 10, 2004
<u>/s/ Warren W. Andrews</u> Warren W. Andrews	Director	September 10, 2004
<u>/s/ Lawrence A. Bennigson</u> Lawrence A. Bennigson	Director	September 10, 2004
<u>/s/ Peter D. Fenner</u> Peter D. Fenner	Director	September 10, 2004
<u>/s/ Richard A. Szafranski</u> Richard A. Szafranski	Director	September 10, 2004
<u>/s/ Alan F. White</u> Alan F. White	Director	September 10, 2004

## INDEX TO EXHIBITS

<u><b>Exhibit Number</b></u>	<u><b>Exhibit Description</b></u>	<u><b>Incorporated by Reference</b></u>				<u><b>Filed Here-with</b></u>
		<u><b>Form</b></u>	<u><b>File No.</b></u>	<u><b>Exhibit</b></u>	<u><b>Fiscal period ended</b></u>	
3.i	Restated Articles of Incorporation dated November 10, 2000	10-Q	001-10981	3.i	9-30-2000	
3.ii	Second Restated and Amended By-laws dated November 13, 2003	10-Q	001-10981	3.ii	12-31-2003	
4.a	Article VI of the Articles of Incorporation, as amended, as included in the Articles of Incorporation of SBS Technologies, Inc.	10-Q	001-10981	3.i	9-30-2000	
4.b	Articles I and II of the Second Restated and Amended By-laws of SBS Technologies, Inc.	10-Q	001-10981	3.ii	12-31-2003	
4.c	Form of certificate evidencing Common Stock	10-Q	001-10981	4.c	3-31-2001	
4.1	Rights Agreement dated as of September 15, 1997 between SBS Technologies, Inc. and First Security Bank (now Wells Fargo), National Association, as Rights Agent, which includes the form of Right Certificate as Exhibit A, and the Summary of Rights to Purchase Common Stock as Exhibit B.2. Agreement to Serve as Rights Agent. On January 21, 1998, pursuant to Section 21 of the Rights Agreement, SBS appointed Norwest Bank Minnesota, N.A. (now Wells Fargo) as Successor Rights Agent.	10-K	001-10981	4.1	6-30-2002	
10.c*	1997 Employee Incentive Stock Option Plan.	10-K	001-10981	10.c	6-30-2002	
10.i *	1993 Director and Officer Stock Option Plan (as amended).	10-K	001-10981	10.i	6-30-2002	
10.v *	1996 Employee Stock Purchase Plan (as amended).	10-K	001-10981	10.v	6-30-2002	
10.ac	Office/Warehouse Lease Between Lutheran Brotherhood, (a Minnesota Corporation), and Bit 3 Computer Corporation, a wholly-owned subsidiary of SBS Technologies, Inc., dated September 5, 1997	10-Q	001-10981	10.ac	9-30-2002	
10.ad	Amendment #1 to Lease between Lutheran Brotherhood, a Minnesota Corporation, and Bit 3 Computer Corporation, a wholly owned subsidiary of SBS Technologies, Inc., dated December 23, 1997	10-Q	001-10981	10.ad	9-30-2002	
10.ah	Standard Industrial Lease Between Carlsbad Business Park, LLC, (a California Limited Liability Company), and SBS Technologies, Inc. dated September 10, 1998					X
10.al	Lease Agreement between Mair GmbH & Co. KG and or Industrial Computers GmbH, a wholly-owned subsidiary of SBS Holding GmbH, a wholly-owned subsidiary of SBS Technologies, Inc.					X

## INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Exhibit Description</u>	Incorporated by Reference				<u>Filed Here-with</u>
		<u>Form</u>	<u>File No.</u>	<u>Exhibit</u>	<u>Fiscal period ended</u>	
10.am *	1998 Long-Term Equity Incentive Plan.	10-K	001-10981	10.am	6-30-2003	
10.an	Partnership Agreement between SBS or Industrial Computer GmbH & Co. KG and SBS or Industrial Computers Verwaltungs GmbH, general partner, and SBS Technologies Holding GmbH, limited partner					X
10.ao	Lease Agreement between 8-L Newark 8371, LLC and SBS Technologies, Inc. dated August 14, 1999					X
10.ax	Lease between AFC-5, LLC, a New Mexico limited liability Company, and SBS Technologies, Inc., dated May 16, 2000	10-K	001-10981	10.ax	6-30-2000	
10/ay	Lease between Long Gate, LLC, a Delaware limited liability company, and SDL Communications, Inc., a Massachusetts corporation, dated June 15, 2000	10-K	001-10981	10/ay	6-30-2000	
10.be *	2000 Long-Term Equity Incentive Plan	DEF 14A	001-10981	Exhibit "A"	10-2-2000	
10.bt	Amendment #2 to Lease between Oakview Eagan Investors, LLC (a Delaware Limited Liability Company), as successor in interest to Lutheran Brotherhood, (a Minnesota Corporation), and SBS Technologies, Inc., Commercial Group, formerly known as Bit 3 Computer Corporation, a wholly-owned subsidiary of SBS Technologies, Inc., dated May 22, 2002.	10-K	001-10981	10.bt	6-30-2002	
10.bu	Amendment #1 to Lease between AFC-5, LLC (a New Mexico Limited Liability Company) and SBS Technologies, Inc., dated February 1, 2001.	10-K	001-10981	10.bu	6-30-2002	
10.bv	Amendment #2 to Lease between AFC-5, LLC (a New Mexico Limited Liability Company) and SBS Technologies, Inc., dated April 1, 2002.	10-K	001-10981	10.bv	6-30-2002	
10.bw	Lease Agreement between Teal Properties, LLC and SBS Technologies, Inc. dated October 2, 2002.	10-Q	001-10981	10.bw	9-30-2002	
10.by *	Employment agreement between Christopher J. Amenson and SBS Technologies, Inc., effective April 17, 2003, dated April 17, 2003	10-Q	001-10981	10.by	9-30-2003	
10.bz *	Employment agreement between Clarence W. Peckham and SBS Technologies, Inc., effective April 17, 2003, dated April 17, 2003	10-Q	001-10981	10.bz	9-30-2003	
10.ca *	Employment agreement between James E. Dixon, Jr. and SBS Technologies, Inc., effective July 29, 2003, dated July 29, 2003	10-Q	001-10981	10.ca	9-30-2003	
10.cb *	Employment agreement between David Greig and SBS Technologies, Inc., effective July 29, 2003, dated July 29, 2003	10-Q	001-10981	10.cb	9-30-2003	
10.cc *	Employment agreement between Bruce E. Castle and SBS Technologies, Inc., effective July 29, 2003, dated July 29, 2003	10-Q	001-10981	10.cc	9-30-2003	

## INDEX TO EXHIBITS

<u><b>Exhibit Number</b></u>	<u><b>Exhibit Description</b></u>	<u><b>Incorporated by Reference</b></u>				<u><b>Filed Here- with</b></u>
		<u><b>Form</b></u>	<u><b>File No.</b></u>	<u><b>Exhibit</b></u>	<u><b>Fiscal period ended</b></u>	
10.cd	Sublease agreement between SBS Technologies, Inc., and Viasat, Inc., a Delaware corporation, dated October 29, 2003	10-Q	001-10981	10.cc	12-31-2003	
10.ce	Lease Agreement between Sabine u. Hermann Götzfried GbZ and ortec Electronic Assembly GmbH dated August 2003					X
10.cf	Amendment #4 to Lease between AFC-5, LLC (a New Mexico Limited Liability Company) and SBS Technologies, Inc., dated August 1, 2003					X
10.cg	Amendment to lease agreement between 8-L Newark 8371, LLC and SBS Technologies, Inc. dated May 5, 2004					X
10.ch	Lease Agreement between Shenzhen Jiannian Travel Limited and SBS Technologies, Inc. Foreign Holding Company dated June 2004					X
14	Code of Ethics.	8-K	001-10981	14	11-21-2003	
21	Subsidiaries of the registrant.					X
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm					X
24.1	Power of Attorney (see page 62 of this Form 10-K)					X
31.1	Section 302 certification of Clarence W. Peckham, Chief Executive Officer					X
31.2	Section 302 certification of James E. Dixon Jr., Chief Financial Officer					X
32.1	Section 906 certification of Clarence W. Peckham, Chief Executive Officer					X
32.2	Section 906 certification of James E. Dixon Jr., Chief Financial Officer					X

\* Indicates a management contract or compensatory plan or arrangement.

## Diversity Statement

It is the policy of SBS to afford equal opportunity for employment to all individuals regardless of race, color, religion, gender, national origin, age, disability, veteran status, pregnancy, or sexual orientation. The Board of Directors of SBS is committed to this policy.

## Corporate Governance

At SBS, we strive to achieve excellence and integrity in all of our business practices, including corporate governance, oversight, accountability and transparency. We believe we have incorporated best practices in our governance, including those currently required by the Sarbanes-Oxley Act of 2002 and the Nasdaq Stock Market®. Examples of our corporate governance initiatives, many dating several years before the passage of the Sarbanes-Oxley Act, can be viewed in our attached Annual Report on Form 10-K and at [www.sbs.com/ir](http://www.sbs.com/ir).

## Forward-Looking Statements

This document contains certain "forward-looking statements" within the meaning of the federal securities laws. These statements are based on management's current expectations and are subject to uncertainty and changes in factual circumstances. The forward-looking statements include statements addressing future financial and operating results of SBS. Actual results may vary materially from the expectations contained in the forward-looking statements.

The following factors, among others, could cause actual results to differ materially from those described in the forward-looking statements: changes in business conditions and the economy in general, changes in market demand, allocations of products by suppliers and failure to obtain and retain expected synergies from newly acquired businesses of SBS generally.

More detailed information about these and other factors is set forth in our attached Annual Report on Form 10-K.

## Corporate Headquarters

2400 Louisiana Blvd. NE  
AFC Building 5, Suite 600  
Albuquerque, New Mexico 87110

## Board of Directors

### INSIDE DIRECTORS

**Christopher J. Amerson**  
Chairman of the Board

**Clarence W. Peckham**  
Chief Executive Officer

### INDEPENDENT DIRECTORS

**Warren W. Andrews**  
Publisher and Editorial Director  
RTC Magazine and COTS Journal

**Lawrence A. Bennigson, PhD**  
Senior Vice President and  
Senior Fellow, Harvard Business  
School, Executive Education Custom  
Programs

**Peter D. Fenner**  
Former President and CEO  
Com21, Inc.

**Richard Szafranski**  
Managing Partner  
Toffler Associates®

**Alan F. White**  
Senior Associate Dean  
Sloan School of Management  
Massachusetts Institute of Technology

## Executive Officers

**Clarence W. Peckham**  
Chief Executive Officer

**Christopher J. Amerson**  
Executive Chairman

**David H. Greig**  
President & Chief Operating Officer

**James E. Dixon, Jr.**  
Executive Vice President,  
Chief Financial Officer & Treasurer

**Bruce E. Castle**  
Vice President, General Counsel  
& Secretary

## Legal Counsel

**Schuler, Messersmith, Daly & Lansdowne**  
Albuquerque, New Mexico

## Independent Auditors

**KPMG LLP**  
Albuquerque, New Mexico

## Transfer Agent

**Wells Fargo Bank, N.A.**  
161 North Concord Exchange  
St. Paul, Minnesota 55075 -OR-  
Post Office Box 64854  
St. Paul, Minnesota 55164-0854  
1 (800) 468-9716

## Form 10-K

The Company's Annual Report to the Securities and Exchange Commission on Form 10-K (excluding exhibits) is contained within this document and will be furnished without charge to stockholders upon written request to:

## Investor Relations

**Jennifer D. Wade**  
Vice President, Investor Relations  
SBS Technologies, Inc.  
2400 Louisiana Blvd. NE, #5-600  
Albuquerque, NM 87110  
ir@sbs.com, (505) 875-0600

## Annual Meeting

Monday, November 18, 2004  
8:30 a.m. MST  
Sheraton Uptown Albuquerque Hotel  
2600 Louisiana Blvd. NE  
Albuquerque, NM 87110

## Trading and Dividend Information

SBS Technologies, Inc.'s Common Stock trades on the Nasdaq Stock Market® under the symbol SBSE.

SBS has not paid any cash dividends on its Common Stock. Management's current policy is to retain earnings, if any, for use in SBS' operations and for expansion of the business.

## Common Stock Market Price

	High	Low
<b>Fiscal 2004</b>		
First Quarter	\$13.93	\$9.17
Second Quarter	\$17.00	\$9.89
Third Quarter	\$17.75	\$14.30
Fourth Quarter	\$19.46	\$12.72
<b>Fiscal 2003</b>		
First Quarter	\$12.30	\$5.00
Second Quarter	\$12.00	\$6.25
Third Quarter	\$9.90	\$7.06
Fourth Quarter	\$9.94	\$6.51

The closing price on August 25, 2004 was \$11.15.

As of August 25, 2004, there were approximately 215 shareowner accounts of record, as defined by Rule 12g5-1 of the Exchange Act.

[www.sbs.com](http://www.sbs.com)



## 2004 Annual Report

[www.sbs.com](http://www.sbs.com)

### **Corporate Headquarters**

2400 Louisiana Blvd. NE, Suite 5-600  
Albuquerque, NM 87110  
Toll Free: 800-SBS-1553  
Phone: 505-875-0600  
Fax: 505-875-0400

Email: [info@sbs.com](mailto:info@sbs.com)

### **Europe**

Memminger Str. 14  
D-86159 Augsburg, Germany  
Phone: +49-821-5034-0  
Fax: +49-821-5034-119

Email: [aug-info@sbs.com](mailto:aug-info@sbs.com)

### **Asia Pacific**

Room 501-502  
Cyber Times Tower B,  
Tianan Cyber Park  
Futian District,  
Shenzhen, 518041 CN

Email: [china-sales@sbs.com](mailto:china-sales@sbs.com)